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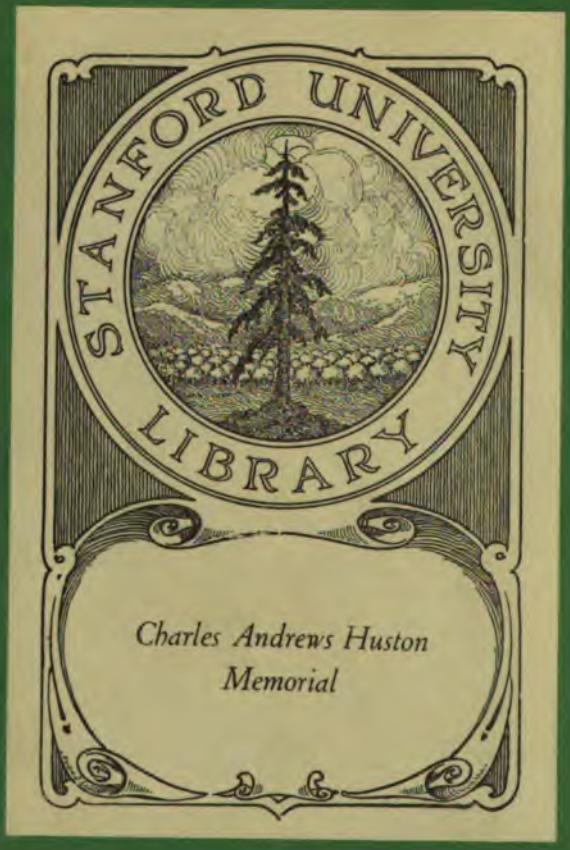
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PREPARED BY

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PREFACE.

The contents of this volume include four closely allied branches which are of increasing legal and commercial importance. "Law of Private Corporations," by Professor I. Maurice Wormser, of Fordham University; "Law of Partnership," by Professor Eugene A. Gilmore, of Wisconsin University; "Law of Banks and Banking," by Mr. James Love Hopkins, of the St. Louis bar; and "Law of Receivers," by Dean T. J. Moll, of American Central Law School, are treated in the order named, and with a clear understanding of the modern problems they present.

The reasoning on which the rules, as enforced, are based, and the presentation of discriminating commentaries on the peculiar doctrines in the law of these subjects will serve to reduce to an appreciable extent any confusion that has existed in applying their underlying principles.

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LAW OF PRIVATE CORPORATIONS

BY

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CHAPTER I.

THE LEGAL CONCEPTION OF A CORPORATION.

1. **Historical development.**—The idea of the corporation is said to have been known to the ancient Greeks. It is certain that not only were corporations recognized by the Roman law, but that they were a familiar feature of Roman civilization. "Roman law," says Sohm, "contrived to accomplish a veritable masterpiece of juristic ingenuity in discovering the notion of a collective person; in clearly grasping and distinguishing from its members the collective whole as the ideal unity of the members bound together by the corporate constitution; in raising this whole to the rank of a person (a juristic person, namely), and in securing it a place in private law as an independent subject of proprietary capacity, standing on the same footing as other private persons."[1]

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[1] Rudolph Sohm, Institutes of Roman Law, pp. 105-6.

After the fall of Rome, corporations ceased to be of any significance for many centuries. With the development of civilization and commerce in the sixteenth and seventeenth centuries came the era of the great, trading joint stock companies. Familiar illustrations are the Hudson Bay Company, the Dutch East India Company, and the Merchant Adventurers who settled Plymouth, New England. These were the direct forerunners of the modern corporation. Before the Revolutionary War, corporations were infrequent and far between in the New World. In fact, they were regarded with jealousy and suspicious misgiving.

2. **Modern importance.**—Today, the greater part of business, in England, on the Continent, and in this country, is conducted by means of the private corporation as a type of business organization. By means of it, the widow with her humble mite and the captain of industry with his many millions may alike be interested in an industrial enterprise. One of our leading scholars, Dr. Nicholas Murray Butler, of Columbia University, has expressed the opinion that the marvelous development of the limited liability corporation is the greatest contribution of our civilization of this era. Certain it is, that the number and importance of corporations are daily increasing. In size, they range from the most insignificant to the gigantic United States Steel Corporation with its thousands of stockholders and its capital of hundreds of millions of dollars. To the lawyer, no subject in the wide domain of jurisprudence presents more interesting and striking problems.

3. **Definitions.**—Corporations have been defined in many ways. Chief Justice Marshall defined a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law."[2] Kyd defined it as: "A collection of many individuals united into one body, under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law with the capacity of acting in several respects as an individual."[3] Chancellor Kent's definition is: "A corporation is a franchise possessed by one or more individuals, who subsist, as a body politic, under a special denomination, and are vested, by the policy of the law, with the capacity of perpetual succession, and of acting in several respects, however numerous the association may be, as a single individual."[4]

These definitions emphasize, respectively, that a corporation is regarded as a legal person, as a collection of individuals, and as existing by virtue of permission from the state under a franchise.

Blackstone lays stress upon the "legal immortality" of natural persons "when they are consolidated and united into a corporation," that is, into "one person in law." He says: "The privileges and immunities, the estates and possessions, of the corporation, when once vested in them, will be forever vested, without any new conveyance to new succession; for all the individual members that have existed from the foundation to the present time, or that shall ever here-

[2] Per Ch. J. Marshall in Dartmouth College v. Woodward, 4 Wheat. 518, 636 (U. S.).

[3] 1 Kyd, Corporations, p. 13.

[4] 2 Kent, Commentaries, pp. 267-8.

after exist, are but one person in law—a person that never dies; in like manner as the River Thames is still the same river though the parts which compose it are changing every instant."[5]

4. **Same subject.**—In the last analysis, it would seem most accurate to define a corporation as a group of persons authorized by sovereign authority to act as a legal unit.

Judge Vann, of the New York Court of Appeals, in a recent decision, said: "A corporation is a mere conception of the legislative mind. It exists only on paper through the command of the legislature that its mental conception shall be clothed with power."[6] This, it is submitted, is inaccurate. A corporation is a reality as truly as is an army, a class in a college, or any other collective unit. Whatever of fiction or of "paper" existence is involved in the corporate concept is found in the law's endowment of the corporation with legal personality. That is, the law authorizes the corporation to act as though it were a person,—which it assuredly is not,—except in contemplation of law. Only in this respect is there anything of fiction.

5. **Corporations distinguished from other forms of business organization.**—At the outset, the partnership should be differentiated from the corporation. First, if a partner dies, the partnership thereby ceases. If a partner sells, or otherwise transfers, his interest in the firm, the partnership is automatically dissolved. In the case of the corporation, the

[5] 1 Blackstone, Commentaries, pp. 467-8.
[6] People v. Knapp, 206 N. Y. 373, 99 N. E. 841.

situation is the precise opposite. The death of a shareholder in no respect affects the corporate existence. Nor does the fact of a shareholder's transfer of his stock affect the corporation. Just as the Mississippi River continues to flow on despite the constant changes in the molecules of water which compose it, so the corporation continues despite changes in its membership. The Union Pacific Railroad Company, with its hundreds and hundreds of stockholders, is not in any respect affected, so far as its continued existence is concerned, when a stockholder dies or sells his shares of stock, many in number as those shares may be.

Second, in a partnership, unless it is otherwise provided, each partner is an agent for the partnership, and his acts are binding upon the firm. A corporation, on the other hand, is managed by its duly elected board of directors and officers. The individual stockholder cannot bind the corporation by his acts or contracts, unless the board of directors has appointed him an agent on behalf of the corporation, in which event, what he does, binds the corporation, but on account solely of the authority conferred upon him, not because he chances to be a stockholder.

Third, a partner is liable to the last dollar of his personal fortune for the full extent of the firm's indebtedness. If the firm's obligations are great, every dollar he owns in the world may be lost to him. The stockholder in a corporation, whose shares are paid for, however, is not liable for a penny of the corporate indebtedness. The debts of the corporation are its debts, and only its. They are not his, and his

private fortune cannot be touched. All he loses is the amount which he has invested in the company. Only in the case of a few kinds of corporations—e. g., the national banks—has the common-law rule been modified, and even in such cases of statutory modification, the stockholder is rarely made liable by the statute beyond the total par value of the shares of stock owned by him.

Fourth, a partnership can be created by mere agreement of the parties. A corporation, though, requires over and above the contract of the incorporators the consent and sanction of the state. As said by the Supreme Court of Illinois, "A corporation cannot be constituted by the agreement of parties. It can only be created by or under legislative enactment."[7] Similarly, a corporation can be lawfully dissolved only by or with the consent of the state, whereas partners may dissolve at any time.

Fifth, a partnership may do anything by agreement among the partners which is not unlawful. A corporation, on the other hand, cannot lawfully exercise any powers save those expressly conferred upon it or to be reasonably implied from those conferred, and its powers cannot be enlarged without the consent of the state.

Sixth, and perhaps most important, in theory of existence, a corporation is regarded as a legal entity distinct and separate from the members which compose it. While merchants and the man in the street often look upon the partnership as an entity, it is not so considered in law except in a very few cases.

[7] Stowe v. Flagg, 72 Ill. 397.

This is the fundamental and the basic difference between the legal conception of a private corporation and a partnership.

6. **Same subject—Joint stock companies.**—Occupying a twilight zone between the partnership, upon the one side, and the corporation, upon the other, stands the joint stock association. It might be defined as a big partnership possessed of some of the attributes usually attributed to corporations. Shares therein, for example, are ordinarily transferable, and a member, as such, has no authority to bind the association. Individual liability exists, however, for the indebtedness of the association, unless expressly abolished by statute. As has been seen, in corporations exactly the reverse is true, there existing no individual liability of the members unless created by special enactment. Familiar instances of joint stock associations are the great express companies, such as the Adams Express Company and the United States Express Company.

As the result of modern statutes, joint stock associations have been endowed with so many of the familiar attributes of the private corporation that the lines of distinction between the two, however far apart in the beginning, have become vague and very ill-defined. In 1892, the New York Court of Appeals said: "More or less, they crowd upon and overlap each other, but without losing their identity, and so, while we cannot say that the joint stock company is a corporation, we can say, as we did say in Van Aernam v. Bleistein, 102 N. Y. 360, that a joint stock company is a partnership with some of the

powers of a corporation. Beyond that, we do not think it is our duty to go."[8]

On the other hand, in 1907, Judge Hiscock, of the same learned court stated that so many corporate characteristics had been conferred by statute upon the Adams Express Company that there was ample justification for viewing it as a "quasi corporate entity."[9] And in the same case, Judge O'Brien, concurring, said: "A joint stock company, whatever else may be said about it, is certainly for most, if not all, practical purposes a legal entity capable in law of acting and assuming legal obligations quite independent of the shareholders." It is thus clear that, to some extent, the idea that the joint stock companies occupy some undefined borderland midway between the partnership and the corporation has faded away. It has recently been held, however, in Rountree v. Adams Express Company,[10] that an averment in a bill that the complainant is a joint stock company is not equivalent to the statement that it is a corporation, following a decision of the United States Supreme Court, rendered in 1889.[11]

7. **Tests of corporate existence.**—In some cases it is difficult to determine whether a particular institution is a corporation or not. The only vitally essential corporate attributes are: first, that the association should be authorized by the sovereign; and second, that the members should be combined into a legal unit. The declaration of the legislature that the

[8] People ex rel. Winchester v. Coleman, 133 N. Y. 279, 31 N. E. 96.
[9] Hibbs v. Brown, 190 N. Y. 167, 82 N. E. 1108.
[10] 165 Fed. 152, 91 C. C. A. 186.
[11] Chapman v. Barney, 129 U. S. 677.

association shall or shall not be regarded as a corporation is generally assumed to be binding within the jurisdiction. But in foreign states or countries, the powers conferred and the nature of the association, rather than the legislative declaration, will control. Thus, New York might charter a company conferring upon it every characteristic which we familiarly attribute to corporations, and yet declare that it shall not be regarded as such. While in the domestic jurisdiction, this might properly be regarded as absolutely controlling, yet Illinois might lawfully tax the body as a corporation, under an act taxing corporations, viewing its character and essential nature rather than the mandate of the legislature in New York, which is, in no sense, necessarily conclusive upon foreign jurisdictions.[12]

8. **Advantages of incorporation.**—The corporation of today is a prime economic necessity, made so by the huge amounts of capital required to finance many kinds of modern enterprise. As a form of business organization it presents the following advantages: First, any number of persons, even tens of thousands, may unite in an enterprise and act as though they were in fact what they become in law—a single person. This is equally an advantage to the stockholders and to human society in general. It makes great undertakings feasible. Second, as much or as little need be dedicated to the corporate enterprise as the investing stockholder sees fit to risk.

[12] See Liverpool Insurance Co. v. Massachusetts, 10 Wall. 566 (U. S.). Compare Edwards v. Warren Linoline & Gasoline Works, 168 Mass. 564, 47 N. E. 502.

Besides, with a very few classes of corporations excepted, his investment in the shares is the extent of what the stockholder stands to lose if the undertaking does not succeed, whereas if the business had been organized on a partnership basis, every dollar of the associates' individual fortunes might be lost as well. Third, a corporation continues despite changes in its membership. A natural person's activities are limited by the short span of human life, whereas a corporation enjoys continuing existence and, except so far as restrained by positive statutory limitations, may endure forever. The desirability, all things considered, of the corporate type of business organization is best demonstrated, in practical fashion, by their ever-increasing importance, size, wealth, and numbers. If appropriately regulated and supervised, corporations, far from being a menace to society, constitute one of its most substantial blessings.

9. **Corporation considered as an entity distinguished from its shareholders.**—Easily the most distinctive attribute of the corporation is its existence as a legal entity distinct and separate from the stockholders who compose it. It is a distinct entity, an artificial person, and, as such, is capable of suing and being sued, of contracting, of acquiring, owning, and disposing of property, within the objects of its creation, the same as a natural person, and one may deal with it, respecting its corporate property, the same as with an individual owner. This is because the law has endowed it with a legal existence, as a juridical person, independent of any or all of its stockholders. Suppose that A owns ten shares of stock in a cor-

poration whose total capital is divided into one hundred shares. Does A, by virtue of this, own one-tenth of the corporate property? The answer is that A does not. True, A is interested, and most vitally, in the corporation. A is entitled to his share of the surplus profits, for instance, obtained from the use and management of the capital. But in no legal sense is A the owner of the corporate property or any part thereof. A and his fellow shareholders do not own the corporate property jointly or in common. The corporation, the legal entity, owns the property. It, and it alone, is the owner. Title is vested in the corporation, not in the stockholders. Suppose the same corporation enters into a contract with X and subsequently breaches it. Can X sue A and recover the damages, or one-tenth part thereof, from A? The answer is that the corporation alone is liable. X contracted with it and can hold it alone. "Whenever a corporation makes a contract, it is the contract of the legal entity, of the artificial being created by the charter, and not the contract of the individual members," said Chief Justice Taney, in Bank of Augusta v. Earle,[13] and so our courts have uniformly held.

A British statute forbade the registration of any vessel owned by foreigners, "in whole or in part, directly or indirectly." A corporation duly chartered by Great Britain, many of whose shareholders were foreigners, sought to compel the registry of its vessel. Held, the vessel should be registered. The decision rests upon the proposition that the British corporation was the legal owner of the vessel and,

[13] 13 Pet. 519, 587 (U. S.).

therefore, entitled to register it. "In no legal sense are the individual members the owners," said the court.[14] Therefore, their foreign citizenship could be ignored, and it was.

In an Illinois case the question arose whether a promise by stockholders in a corporation to pay its debt was a promise to pay the debt "of another" within the Statute of Frauds. Held, it was. Said the court: "A corporation is, in law, a different person from any of its members. A promise by a stockholder to pay a corporate debt is in every sense a promise to pay the debt of another."[15]

Suppose X, Y, and Z own all of the shares of stock of the United States Steel Company. Suppose the same individuals own all of the stock in the New York City Railway Company. Are the two corporations identical? The question answers itself. Surely the two corporations are not the same. Thus it is clear that corporations are legal entities, distinct and separate from the individual shareholders composing them, and must be so treated.

Sometimes one individual acquires the entire stock in a corporation. Are he and the corporation one and the same? This question has been considered frequently by the courts and, with practical uniformity, answered in the negative. In Baldwin v. Canfield,[16] one King, the owner of all the stock in a corporation, executed and delivered a deed of certain real estate owned by it. An action was subsequently brought to

[14] Queen v. Arnaud, 9 Q. B. (Adol. & El.) 806 (Eng.), LEADING ILLUSTRATIVE CASES.

[15] Home Nat. Bk. v. Estate of Waterman, 134 Ill. 461.

[16] 26 Minn. 43.

have the deed declared void as a cloud upon the title of the corporation. Held, the action would not lie, that the deed was "void upon its face," and therefore not a cloud upon the title, "being the deed of a total stranger to the title." So, also, where all the stockholders individually join in a deed of the corporate property.[17] And in the leading case of Button v. Hoffman,[18] the Supreme Court of Wisconsin decided that the sole owner of all the capital stock of a corporation could not maintain an action of replevin to recover property unlawfully taken from the corporation, since title was not in him but in the corporate entity. Orton, J., said: "The owner of all the capital stock of a corporation does not, therefore, own its property, or any of it, and does not himself become the corporation, as a natural person, to own its property and do its business in his own name. While the corporation exists he is a mere stockholder of it, and nothing else."

10. **Same subject.** — Two further illustrations of the working of this doctrine deserve consideration. In People's Pleasure Park Co. v. Rohleder,[19] a large tract of land was divided up into a number of lots, each deed of a lot containing a covenant providing that title to the realty should never vest in a person or persons of African descent or in a colored person or persons. Subsequently, several of the lots were conveyed to a corporation "composed exclusively of negroes." It proposed to establish an amusement

[17] See Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S. W. 209.
[18] 61 Wis. 20, 20 N. W. 667, LEADING ILLUSTRATIVE CASES.
[19] 109 Va. 439, 61 S. E. 794.

park for colored people. It knew, when it purchased, of the restriction. Thereupon suit was brought in equity by an owner of other lots to cancel the deed to the corporation. Held, for the corporation. Even though all the members thereof, declared the court, were negroes, yet since the corporation was an entity apart and distinct from its members, the covenant was not breached. Caldwell, J., said: "Such a conveyance, by no rule of construction, vests the title to the property conveyed in 'a person or persons of African descent.'" On rehearing, this result was affirmed for a second time.

In another case,[20] the X corporation filed a bill against the Y corporation to enjoin it from selling agricultural implements. It appears that in May, 1887, a contract was entered into between the X corporation and a partnership, engaged in selling agricultural implements, and composed of A, B, and C, whereby the partners sold out their entire stock in trade and good will to the X corporation and agreed not to handle any more agricultural implements of any kind in the vicinity. In March, 1888, A, B, and C organized the Y corporation and became its sole stockholders. The Y corporation was, as its articles of incorporation disclosed, organized for the purpose of carrying on, and it did begin to carry on, the same general business which the partnership had previously conducted. The bill did not state, in terms, that A, B, and C formed the Y corporation in order fraudulently to evade the force and effect of their

[20] Moore & Handley Hardware Co. v. Towers Hardware Co., 87 Ala. 206, 6 So. 41.

agreement with the X corporation, but it did charge that the effect of their formation of the Y corporation "would be to perpetrate a fraud." The demurrer of the Y corporation to the bill was sustained, and the distinct existence of the corporation as a separate entity with rights independent from its shareholders was the basis of the result. There is a dictum, however, that had there been positive allegations of fraud in the bill, equity would not have hesitated to hold the corporation liable.

The decisions in such cases as the two last cited have been subjected, especially of recent years, to determined criticism. Extremists of the one type insist that the only safe or sound rule is to adhere strictly and absolutely, regardless of hardship or apparent absurdity, to the doctrine of a corporate entity distinct from the individual stockholders. The extremists of another type argue that the corporation and its shareholders are, after all, one and the same; that corporate entity is a mere empty fiction; and that a corporation, like a partnership, is a mere association of individuals. It is submitted that neither position is sound. In ordinary business transactions, it is essential that the distinction between the corporation, as a legal entity, and its members, be strictly maintained. But, "where the corporate form is used by individuals for the purpose of evading the law, or for the perpetration of fraud, the courts will not permit the legal entity to be interposed so as to defeat justice."[21]

[21] Erickson v. Revere Elevator Co., 110 Minn. 443, 126 N. W. 130, per O'Brien, J.

11. **Same subject—Piercing the veil of corporate entity.**—The nearest approximation to generalization which the present confused state of the authorities (for the law on this topic is still in its making) would warrant is that when the doctrine of separate corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent unfairly a statute, to achieve or perpetuate illegal monopoly, or, generally, to protect knavery, the courts will draw aside the veil of corporate entity, will regard the acts of the flesh-and-blood human associates, and will do justice between natural persons.[22] Similarly, where a corporation is so organized and its affairs are so conducted as to make it a mere instrumentality or adjunct of another corporation, its separate existence as a distinct corporate entity will be ignored.[23] This holds particularly true in courts of equity, but finds many illustrations in courts of law as well. In neither tribunal is the conception of corporate entity to be exalted into an idol to be worshipped at the expense and "in the sacrifice of those who, in the last analysis, are the real parties in interest," namely, the live and doing men and women shareholders.

Two illustrations will suffice. In Donovan v. Purtell,[24] an unscrupulous real estate operator organized a number of "dummy" realty companies. They all had their offices in the same room; they all had substantially the same officers, and the main apparent purpose of their creation was to keep the various

[22] See article by I. Maurice Wormser, 12 Columbia Law Review, pp. 496-518 (June, 1912).

[23] In re Muncie Pulp Co., 139 Fed. 546, 71 C. C. A. 530.

[24] 216 Ill. 629, 75 N. E. 334.

properties owned by the operator out of judgment. The substance of the matter was that the corporations, in point of fact, were really the real estate operator under different cloaks. The court held that an individual who had dealt with one of these corporations as such could hold the operator personally liable. Judge Magruder said: "When appellant received appellee's money, he was not conducting business under a bona fide corporate organization, but was using a corporate entity for the purpose of his private business." Impatience with the notion that the doctrine of corporate entity could be permitted to trammel the ends of justice characterized the decision and the opinion.

In the famous case of State v. Standard Oil Co.,[25] all of the stockholders comprising a corporation entered into an illegal trust agreement with other corporations. This was done in their individual capacities in order to conceal the real nature and object of their actions. The property and business of the corporation were affected to the same extent as if there had been formal corporate action. To prevent the consummation of this monopolistic scheme and the clear abuse of corporate power, the State of Ohio challenged the proceedings in an action of quo warranto to revoke the corporate charter. The defense was that the corporation, as such—the legal entity—could not be affected by the acts of its shareholders; that it could be affected only by its formal corporate acts done on its behalf by its corporate agencies. The Supreme Court of the state ignored the doctrine of

[25] 49 Ohio St. 137, 30 N. E. 279.

separate corporate existence, brushed aside the plea of corporate entity, and did not hesitate to look through it at the actions of the individual stockholders, the acting and living men and women upon whom the franchise had been conferred, and who had transgressed. Minshall, J., said: "* * * Is there, upon an analysis of the agreement, room for doubt that the act of all the stockholders, officers, and directors of the company, in signing it, should be imputed to them as an act done in their capacity as a corporation? We think not, since thereby all the property and business of the company is, and was intended to be, virtually transferred to the Standard Oil Trust, and is controlled, through its trustees, as effectually as if a formal transfer had been made by the directors of the company." This is sound. To permit the doctrine of corporate entity to stand in the way of a decision which public policy requires, to permit restraint of trade to be achieved under the guise of a rule of law, would be abhorrent to the genius of our jurisprudence. It is noteworthy that in the Sugar Trust case in New York a similar decision was made,[26] the court pointing out clearly the ridiculousness of the argument that "while all that was human and could act had sinned, yet the impalpable entity had not acted at all, and must go free." It would be absurd to say that though the stockholders were all guilty, yet the corporate robe that enveloped them was spotless.

12. **Same subject—Recent tendency.**—Of late

[26] People v. North River Sugar Refining Co., 121 N. Y. 582, 24 N. E. 834, LEADING ILLUSTRATIVE CASES.

years, there has been apparent in the cases a marked determination to refuse to permit the entity concept, where employed as a subterfuge, to prevail. A forceful instance is the decision, in 1911, of the United States Supreme Court disregarding the entity in enforcing the so-called "commodities" clause of the Hepburn Act.[27] This clause provides: "It shall be unlawful for any railroad company to transport from any state * * * to any other states * * * any article manufactured, mined, or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have any interest, direct or indirect." The government alleged that the Lehigh Valley Railroad Co. owned stock in a coal company whose product it was carrying, and further that the railroad company was using the coal company merely as a sham, a device, and a dummy to evade the provisions of the law. The court, speaking through Chief Justice White, held that no such evasion could succeed, and, disregarding the corporate entities, and looking at the substance and reality of things, issued an injunction. Every dictate of reason and policy warranted this.

The recent decisions indicate a willingness to apply reasonably the rule of corporate entity where the complex and intricate problems of the modern corporation necessitate this in order to prevent fraud, crime, and injustice. "This much may be expressed without approving the theory that the legal entity is a fiction, or a mental creation; or that the idea of individuality or intangibility is a sophism. A corpo-

[27] U. S. v. Lehigh Valley R. Co., 220 U. S. 257, 31 Sup. Ct. 387.

ration, as expressive of a man's legal rights and powers, is no more fictitious or intangible than a man's right to his own home or his own liberty."[28] These decisions, in the last analysis, indicate perhaps not so much a disregard of the rule of corporate entity as a sane and rational application of that rule in adjusting it to modern business conditions.

13. **Corporation considered as a person.**—Corporations, though juridical persons only, are generally regarded as coming within the purview of the term "person." Thus, a corporation is entitled to immunity under the Fourth Amendment to the Constitution affirming "the right of the *people* to be secure in their *persons*" against unreasonable searches and seizures.[29] Similarly, the provision in the Fourteenth Amendment which forbids a state to deny to any *person* within its jurisdiction the equal protection of the laws, applies to corporations.[30] In Mineral Point R. Co. v. Keep,[31] the question arose whether corporations were included within the word "person" in the Illinois Attachment Act. Held, that they were. The term was "deemed to extend to and include bodies politic and corporate, as well as individuals."

A very interesting recent English decision presents the question whether a corporation can be deemed "a responsible and respectable person."[32] In 1900, P

[28] U. S. v. Milwaukee Refrigerator Transit Co., 142 Fed. 247, at 255, per Sanborn, J.

[29] Hale v. Henkel, 201 U. S. 43, 50 L. Ed. 562.

[30] Santa Clara County v. Southern Pac. R. R. Co., 118 U. S. 394, 30 L. Ed. 118.

[31] 22 Ill. 9.

[32] Willmott v. London Road Car Co., (1910) 2 Ch. D. 525 (Eng.).

leased for a term of sixty-two years certain premises to D, who covenanted for himself, his executors, administrators, and assigns to use the premises for the business of a livery stable keeper, and not to assign or underlet or part with the possession of the premises without the previous written consent of P or his heirs or assigns, but such consent not to be withheld "in respect of a respectable or responsible person." The lease contained the usual power of reëntry on breach of a covenant. In 1908, D sold his business to the London General Omnibus Co., Lim., and applied to P for leave to assign the lease to that corporation. P refused, and thereupon D, without P's consent, let the omnibus company into possession. P began suit to recover the demised premises on the ground that the company was not, and could not be, "a responsible and respectable person," within the meaning of the covenant. D proved that the company was on a going basis and thoroughly solvent, and urged that, therefore, he (D) was entitled to assign the term irrespective of P's consent. Held, in favor of D. A corporation, the court declared in its opinion, can be responsible, respectable, and a person, and dismissed P's action.

14. **Corporation considered as a citizen.**—Is a corporation a citizen within the meaning of Article III, § 2, of the Federal Constitution, which extends the jurisdiction of the federal courts "to controversies between *citizens* of different states"? At first blush, the answer, at least from a standpoint of principle, would apparently be in the negative. How can we conceive of a corporation as a citizen? The great

federal judges, from the early days down to the present time, however, have desired to preserve, to as great an extent as possible, the jurisdiction of the United States courts over corporations. We find it held, accordingly, "that a corporation created by and doing business in a particular state, is to be deemed to all intents and purposes as a person, although an artificial person, * * * capable of being treated as a citizen of that state, as much as a natural person."[33] And that "when the corporation exercises its powers in the state which chartered it, that is its residence, and such an averment is sufficient to give the circuit courts jurisdiction." The same result—namely, that a corporation can be deemed a citizen within this jurisdictional clause of the Constitution—is sometimes also reached by viewing the corporation as an association of persons and then raising an arbitrary fiction, or legal presumption, that these persons are all citizens of the state creating the legal entity.[34] This overcomes, in a roundabout and not altogether satisfactory way, the objection and difficulty that a corporation, as such, cannot very well be regarded as a "citizen," in the ordinary and usual sense of the word.

A corporation, organized under the statutes of a state divided, like New York or Illinois, into more than one federal district, is a citizen and inhabitant, for the purposes of suing and being sued, of that district in the state within which the general corporate business is transacted and where it has its headquar-

[33] Wayne, J., in Louisville, etc., R. Co. v. Letson, 2 How. 497, 558 (U. S.).
[34] Marshall v. Baltimore & Ohio R. Co., 16 How. 314 (U. S.).

ters and general offices. It is not a citizen and inhabitant of any other district.[35]

However, the second section of Article IV of the Constitution, to the effect that "the citizens of each state shall be entitled to all the privileges and immunities of citizens in the several states," does not extend to corporations, and they are not citizens, therefore, within its meaning.[36] Thus, the state of Virginia could impose any arbitrary conditions which it pleased upon a New York corporation desiring to do business in Virginia; or, if the state chooses, could exclude it from its borders altogether. A natural person, a citizen of New York, may transact business in any other state on as favorable conditions as its own inhabitants. Not so, however, as to corporations, which are not treated as citizens within the purview of this provision. It follows that a corporation created by a state can exercise none of the powers, privileges, or functions conferred by its charter in any other state of the Union, except by the comity, with the consent, and pursuant to the permission, of the latter state.

15. **Classification.**—Corporations may be classified as follows:

According to their membership, they are *sole* or *aggregate.* In a sole corporation there can be but one member at a time; corporations aggregate are composed of more than one member at a time. In this country, the corporation sole is practically obsolete. There is said to have been but one corpora-

[35] Galveston, etc., R. Co. v. Gonzales, 151 U. S. 496.
[36] Paul v. Virginia, 8 Wall. 168 (U. S.).

tion sole created by a state legislature, namely the Roman Catholic Archbishop of Chicago, though a governor of a state has been regarded as a quasi-sole corporation.

As to their object or purpose, corporations are *ecclesiastical* or religious, and *lay*; which latter are *eleemosynary* and *civil*.

An ecclesiastical or religious corporation was one composed of spiritual persons, clothed with spiritual jurisdiction, as opposed to temporal, and subject to control by the church authorities. They do not exist in this country, as the state cannot confer such jurisdiction, having none itself. Religious corporations are with us of a civil kind, formed to manage the temporalities of a church. All other than ecclesiastical, were lay corporations, organized for various secular purposes, and were divided into eleemosynary or charitable, formed to distribute the charity of their founders; and civil, which were for any other lay purpose.

In relation to the state authority, corporations are *public, quasi-public* and *private*.

Public corporations are such as are created for the purpose of government and the management of public affairs, as cities and villages, and banks and hospitals, founded by the state and managed by it for governmental purposes.[37] Quasi-public corporations are really private corporations, but on account of their public functions are subject to supervision by the state. A railroad company is an example of such a corporation. Private corporations are such as are

[37] See Board v. Bakewell, 122 Ill. 339; Board v. Houston, 71 Ill. 318.

created for private benefit of the members and which do not involve any peculiarly public purposes, as manufacturing, retailing, etc.

Civil corporations are again divided into *stock* and *non-stock* corporations, as regards the method of acquiring membership therein. In a stock corporation, the ownership of stock or shares entitles such owner to membership. In non-stock corporations, membership is acquired by election or complying with the corporate constitution or by-laws.

16. **Same subject—Scope of this article.**—This article will deal primarily with the private corporation for pecuniary profit. To the business man, no subject in the law is of greater importance, for at one time or another, he is practically certain to become a member of some such organization. To the student of law, no topic in the great field of the law presents more fascinating and more important problems. Besides, it offers a glorious opportunity, for vast areas of our corporation law are still in the slow process of their making.

CHAPTER II.

FORMATION OF CORPORATIONS.

17. **Necessity of sovereign sanction.**—The assent of the sovereign is requisite in order that individuals may act together as a legal unit. Without this approval by sovereign authority, the agreement between the proposed incorporators is ineffective and of no avail. The power to authorize corporations is an incident of sovereignty. None but the sovereign can create, or destroy, the franchise lawfully to act as a corporation.

18. **Evidence of sovereign sanction.**—Conceding that sovereign sanction is essential, how may it be evidenced? At the outset, it should be noted that the word "incorporate," or an equivalent, is absolutely not essential in order to create a corporation. The law is not limited to any prescribed or set form of words or acts.[38] In England this right to act as a legal unit is granted by the king or by Parliament. In this country, by the state legislatures; but the Congress of the United States may, it has been held, create incorporated companies where appropriate and necessary to carry out powers conferred by the Constitution upon the federal government.

At common law, Coke and other early writers maintained that sovereign authorization of incorporation might be evidenced in one of four ways: 1.

[38] Case of Sutton's Hospital, 10 Co. Rep. 23, pp. 30a, b (Eng.).

By letters patent or royal charter from the crown. 2. By the so-called "common law." 3. By prescription. 4. By act of the legislative tribunal, i. e., Parliament.[39]

Originally corporations were created by the crown. Jealousy of the royal prerogative combined with the lessened power of the English king, have resulted in the almost total loss of the crown's powers in this regard, though it is still sometimes exercised, especially in establishing corporations to exploit and develop new colonies and British dependencies. Most corporations, including all purely private companies, are organized today in England under the Companies Acts. These correspond in a general way to our so-called general incorporation laws.

Corporations "by the common law" were such officers whose functions must be performed without break or interruption, e. g., the king. While the individual ruler may die, the monarch in contemplation of law never dies. Wherefrom we derive the saying, "The king is dead—Long live the king!" These are, of course, not corporations in the accepted modern sense of the term.

If a body of men have acted as a corporation for a time to which the memory of man runs not to the contrary, they are regarded as a corporation by prescription. Where A for many years has traversed B's lot openly and notoriously, we say that A acquires an easement by prescription, that is, a prescriptive right to cross B's lot. And we go still further and arbitrarily presume an original lawful

[39] See Co. Lit., 250a (Eng.).

grant of this right to A by B or B's predecessors in the chain of title. So, in the same way, where men have acted as a corporation without opposition for many years, the presumption of the law is that they had originally been vested with a charter so to act, which charter may have been lost or mislaid in the course of time. This reasoning is oftentimes indulged in, as to public corporations in this country; but seldom as to private corporations, though on principle the two classes of cases seemingly rest on the same footing.

Lastly, corporations may be authorized by legislative enactment. In this country corporations are the result of such action, which sanctioned the prior agreement between the would-be incorporators.

19. **Same subject—Power of state legislatures.**—A fundamental limitation upon state legislatures in authorizing incorporations is the necessarily implied restriction in the Federal Constitution that no state may create a corporation for a purpose forbidden in that document, or confer upon corporations created by it powers such as would prevent or hinder the exercise of Congressional powers on the same matter. Secondly, no state legislature can force an individual, against his own consent, to become a member of a private corporation. The agreement between the associates is quite as essential as the "act of state," and it follows that a person cannot be thrust into such an organization willy nilly. This rule does not apply, however, to such corporations as are public or municipal in character rather than private.

20. **Creation by special act.**—In the early days of our national existence, corporations were created by special legislative enactments of the state legislatures or, to use the usual phrase, "by special act." This system led, as any such system must necessarily lead, to glaring and disastrous abuses. Promoters would go to the state capitol to lobby and to influence legislators. Improper persuasion and bribery were freely resorted to. The public interest was ignored. Franchises went, as a rule, to the highest and most shameless bidder. Unfair privileges and powers were boldly sought and, only too often, as boldly conferred. Corporation A and corporation B, both organized to run a general dry-goods business, might have totally different organizations and powers. The system was vicious and ignorant. About the middle of the last century, 1840-50, let us say, a reaction set in against this, which will be considered a little later.

21. **Same subject—Acceptance of charter.**—Acceptance of the charter by the incorporators is requisite. Thus, where the legislature passes an act authorizing X, Y and Z to act as a corporation, with certain rights, privileges and liabilities, this operates by way of an offer, and acceptance thereof according to its terms by X, Y and Z is necessary before it ripens and is binding. "It has long been the received opinion there must be an acceptance, but the mode of proving it has always been left open. In general, the acceptance of a charter has been proved by evidence of acting under it."[40] The acceptance must be

[40] Rex v. Hughes, 7 B. & C. 708, 718 (Eng.).

made within a reasonable time. Like any other acceptance, it must be strictly in the terms of the offer and must be of that which is offered. Acceptance must be made within the jurisdiction and an acceptance without the state is invalid,[41] though sometimes an estoppel to deny corporate existence is raised, under such circumstances, among the associates. The offer may be withdrawn, like any other offer, before acceptance. Thus, where a special act conferring a corporate franchise is passed by the state legislature, but before its acceptance, a constitutional provision was adopted that "Corporations, other than banking, shall not be created by special act, but may be formed under general laws," it was held on demurrer, that the offer was revoked before acceptance and that, therefore, no corporation could lawfully be formed thereunder.[42] When it was made clear at the trial subsequently, however, that the charter was applied for before the legislature conferred it, and was thereupon given, the court declared that the acceptance was immediate and that the corporation had, therefore, accepted the charter before the constitutional provision took effect.[43] The important proposition to note is that it requires, in some form or other, the acceptance of the charter to constitute a corporate body, for no state can compel persons to become a corporation without their duly manifested assent.

22. **Same subject—Modern developments.**—The evils of incorporation by special act led to the enact-

[41] Smith v. Silver Valley Min. Co., 64 Md. 85.
[42] State v. Dawson, 16 Ind. 40, LEADING ILLUSTRATIVE CASES.
[43] State v. Dawson, 22 Ind. 272.

ment of general incorporation laws under which individuals might incorporate in the same uniform manner, pursuant to the same rules and regulations, and with identical privileges. This policy of equality for all and special favoritism to none flourished so readily that many states adopted constitutional provisions to the effect that thereafter private corporations should not be created by special act, but should only be formed under general laws. At the present time, practically every state in the Union has such a clause in its constitution. Legislative jobbery, in this direction, has very greatly diminished as a consequence.

The history of corporate legislation in the State of Illinois is quite typical. The Constitution of 1848 (Art. 10, § 1) read: "Corporations, not possessing banking powers or privileges, may be formed under general laws, but shall not be created by special act, except for municipal purposes, and in cases where, in the judgment of the General Assembly, the objects of the corporation cannot be attained under general laws." The latter clause of the article led to gross improprieties and abuses. Many corporations were still authorized by special charter and were given exceptional privileges. When the Constitution of 1870 was adopted it, accordingly, declared (Art. 11, § 1): "No corporation shall be created by special laws, or its charter extended, changed or amended, except those for charitable, educational, penal or performatory purposes, which are to be and remain under the patronage and control of the state, but the General Assembly shall provide, by general laws, for the

organization of all corporations hereafter to be created." The adoption of this provision was followed two years later by the enactment of a general incorporation act by the state legislature. In several states, however, including New York, the state constitution reserves the right to the legislature to create corporations by special act whenever this is deemed necessary and desirable, and it has been held that the legislative discretion in this regard is arbitrary and not reviewable by the judicial power. The general incorporation acts ordinarily provide that upon the simple filing or recording, pursuant to the statute, of a properly verified document containing certain prescribed information, the individuals filing the same thereby become incorporated without any further action or formalities.

23. **Creation under general laws.**—What the provisions of the general incorporation act of the reader's individual state may be, can be readily ascertained from an examination of the local statutes. The constitutional provisions and the general laws of the various states may also be found, adequately digested in several manuals.[44] In some states, the provisions are far more stringent than in others. Illinois and Kansas, for instance, are emphatically "strict" states. The Dakotas, Delaware, Maine, Nevada and West Virginia are so-called "easy" or "liberal" states, and promoters frequently resort to them in commencing their enterprises. New Jersey, formerly an extremely liberal state and often accused of

[44] See, for example, Parker's Corporation Manual, Stimson's American Statute Law, or Frost's Incorporation and Organization of Corporations.

a desire to obtain incorporation fees in order to augment its revenues, is becoming more severe. Its new laws against monopolies are an instance of the state's progressive tendencies.

When corporations are organized under general laws, "the organic act under which the corporation was formed, together with the articles of association, are to be considered as the charter of the company."[45] In other words, the charter then consists of (1) the provisions of the general law for the organization of corporations and (2) the articles or agreement of association, duly filed or recorded pursuant to the mandate of the statute. The Michigan court, referring to our modern method of incorporation, has declared: "The great purpose of the provision was to introduce a system of legislation in regard to the institution of corporations which would exclude the corruption and party favoritism which had too often accompanied the method previously in vogue, and to secure as far as practicable for all the people of the state an equality of opportunity and a guard against sectional discriminations."[46] In the main, and upon the whole, the system has worked satisfactorily; though, the writer ventures to assert, there is hardly a single state whose general incorporation act is free from serious faults or omissions.

24. **Same subject—Delegation of power by the legislature.**—The power vested in the legislatures to authorize incorporation is manifestly a discretionary power. Being such in its nature, it cannot be dele-

[45] Van Etten v. Eaton, 19 Mich. 187, 194.
[46] Attorney-General v. McArthur, 38 Mich. 204.

gated. Where A appoints B as his agent to sell goods for him as a travelling salesman, B cannot delegate his authority to another. A relies upon the personal performance by B of the powers conferred upon him. So, where the people invest the legislature with the power to create corporations, the legislature, being but the agent of its constituents, cannot transfer the authority delegated to it to any other body, unless expressly empowered by the Constitution to do so. To delegate such authority would be to violate a fundamental principle of political science as well as of jurisprudence. However, this limitation does not prevent the enactment by the legislature of a general law providing for the creation of corporations by complying with the specific requirements thereof, and directing the courts or an executive officer to certify to the fact that compliance therewith has been made. Under such circumstances, no legislative power is delegated to the courts or to the executive officer. There is simply a ministerial act to be performed and no discretion whatever is vested. So clearly is this the case that, without any doubt, an action to compel them would lie if the courts or executive officers refused to discharge the duties imposed upon them, where the requirements of the statute had been duly complied with by the incorporators.

To illustrate. In the leading case of Franklin Bridge Co. v. Wood,[47] the general statute provided that when persons desired to incorporate, they should petition the court of the appropriate county setting forth the object of their association, the privileges

[47] 14 Ga. 80, LEADING ILLUSTRATIVE CASES.

desired, the proposed corporate name, etc., and that thereupon "said court *shall pass a rule or order,* directing said petition to be entered of record on the minutes of said court," and that, thenceforth, the associates should constitute a corporation. The Franklin Bridge Co. was incorporated under this act by an order of the appropriate court, and subsequently sued the defendant for his subscription to its stock. Defendant pleaded that the company was not legally incorporated, contending that the statute was unconstitutional and void. The court upheld the validity of the act and the legality of the corporate organization. Lumpkin, J., said: "Our opinion is, that no legislative power is delegated to the courts by the act under consideration. There is simply a ministerial act to be performed,—no discretion is given to the courts. The duty of passing the rule or order directing the petition of the corporators to be entered of record on the minutes of the court * * * is made *obligatory* upon the courts; and should they refuse to discharge it, a mandamus (a writ to compel an official to perform his duty) would lie to coerce them. It is true the legislature has seen fit to use the courts for the purpose of giving legal form to these companies. But, it might have been done in any other way."

25. **Same subject—Practical workings and effect.** —The general law for the incorporation of private corporations usually enumerates the purposes for which corporations can be formed, contains provisions as to the number of incorporators, provides for a name, duration, amount of stock, shares of stock, location of office, number and qualifications of direc-

tors and officers, liability of members, method of voting, notice of meetings, quorum, and the like. It also makes provision as to the contents of the articles of incorporation, and these provisions must be carefully complied with. General laws usually require that those who wish to incorporate, usually not less than three natural persons competent to contract, shall enter into written articles of incorporation, sign and acknowledge the same, as they would a deed, and file these articles with some specified public officer, who is to record the same, if it complies with the law, and furnish a certified copy thereof under the seal of the state to the applicants; this copy, so authenticated, is usually made prima facie evidence of the existence of the corporation. The general law usually requires these articles to set forth the name of the corporation, its purpose and objects, location of main office, duration, amount of stock, number of shares, officers, directors for the first year and, in some cases, other matters. The articles must be made to conform to the requirements of the general law, all inconsistent provisions being treated as surplusage and void, and usually cannot, even though claimed, secure any powers except such as are allowed by the general law. In several states, however, all powers claimed by the incorporators in their articles are held to be created unless forbidden expressly by the general law. In drafting the clause of the articles relating to the purpose and objects of the corporation and the powers desired, great care and foresight should be exercised. The reason is that a corporation is a creature of limited powers, possessing only those powers expressly

conferred upon it or to be derived therefrom by necessary implication. A "stitch in time" saves many a later doubt. In general, it is wise to make the enabling clause as wide in scope as possible, i. e., as broad as the statute itself. Then, no question as to want of power is apt to arise.

Where corporations are formed, in this manner, under general laws, the "franchise" is clearly of a very different type than the franchises known to the early common law. As said by Chief Justice Horton, of Kansas, "The word 'franchise' is generally used to designate a right, or privilege, conferred by law. What is called 'the franchise of forming a corporation,' is really but an exemption from the general rule of the common law prohibiting the formation of corporations. All persons in this state have now the right of forming corporate associations upon complying with the simple formalities prescribed by the statute. The right of forming a corporation, and of acting in a corporate capacity under the general incorporation laws, can be called a franchise only in the sense in which the right of forming a limited partnership or of executing a conveyance of land by deed, is a franchise."

26. **Same subject—Concrete illustration.**—An illustration of how a corporation is actually formed seems desirable. Let us take the procedure in Illinois, for example, which is reasonably typical. The first step is to draw up the articles of incorporation. The incorporators must be not less than three nor more than seven in number. The articles should contain: 1. The proposed corporate name. 2. Its ob-

jects. 3. Total capital stock. 4. The number of shares and the par value of each share. 5. The location of the chief corporate office. 6. The duration (in Illinois not more than 99 years). The incorporators sign and acknowledge this document and send same, together with the requisite fees, to the Secretary of State, who thereupon issues a license to organize. The incorporators then endeavor to obtain subscriptions, and when the capital stock is subscribed for (in Illinois all must be subscribed for), they issue a call for a subscribers' meeting. This must be in writing and, unless waived, must be sent to each subscriber ten days before the date set. At this meeting, temporary officers are first elected, and then follows the election of directors. Directors are the managers of the general corporate business. Shortly thereafter, or still better, immediately following, the first meeting of the directors should be held. At this meeting, corporate officers, e. g., president, vice-president, secretary and treasurer, should be chosen and by-laws adopted. By-laws are rules which regulate the conduct of the internal government and management of the corporation and its officers. Though in most states, they are enacted by the stockholders, in some, including Illinois, they are enacted by the directors. The directors should also see to it that, as required by the statute, the requisite percentage of the capital stock is paid in. Illinois requires one-half to be paid in, on organization, either in cash or in property. After this has been accomplished, the incorporators then send a written report of all that has been done, duly verified, to the

Secretary of State. It is entered on file in his office, and he issues a charter to the incorporators conferring corporate powers upon them, and authorizing them to commence business within two years from its date. If this be not done, the charter lapses and becomes void. When the incorporators receive the charter from the Secretary of State, they are required to file it in the office of the recorder of the county where the principal business office of the corporation is to be located. When this has been done, the associates are a complete and perfect corporation, a corporation de jure, and may proceed lawfully to transact business as a private corporation.

27. **Creation by implication or consolidation.**—Suppose privileges, rights and immunities are accorded by the state to a group of persons consistent only with the theory that they are to act as a corporation, then such association is regarded as a corporation *by implication* and to the extent necessary. The test is the faculties conferred rather than the express use of the term "corporation."

Suppose two or more corporations wish to amalgamate into one and act as one legal unit thereafter. The legislature, unless constitutional restrictions forbid it, may provide for this situation and create a new corporation by *consolidation* of the old ones. This is frequently resorted to. The ordinary, though not the necessary, consequence is the legal death of the constituent companies and the legal birth of a new and distinct corporate entity.

28. **Power of federal government to create corporations.**—It is now well settled that Congress can

create corporations in order adequately and properly to carry out any of the powers conferred upon the national government by the Federal Constitution. Thus, in controlling interstate commerce, control over which is vested in Congress, the creation of one or more corporations may become necessary. As a *means* to the attainment of this object, Congress may create, and has created, federal corporations. It can, in other words, create a corporation as a *means*, though perhaps not as an *end*. Especially in the early days of the Republic, the power of Congress to create corporations was bitterly assailed. The Constitution neither expressly authorizes nor forbids it. The strict constructionists insisted that since the federal government was one of limited powers, and this power had not been conferred, it was not possessed. Jefferson, for instance, took this view. On the other hand, Hamilton, Marshall, and the school of liberal construction contended, first, that the creation of corporations was a necessary attribute of sovereignty, and, secondly, that Congress has, as an implied power and as necessarily incidental to its express powers, the right to authorize any corporation which it may deem reasonably necessary in order to carry out suitably its vested powers. The quarrel during Washington's administration over the right of Congress to create a National Bank was the first act in the mighty drama which culminated in the famous decision of the Supreme Court of the United States, in McCulloch v. Maryland,[48] upholding this privilege. A notable example of its exer-

[48] 4 Wheat. 316 (U. S.).

cise is the creation of a corporation for the construction of the canal at Panama. As the powers of our government, in the course of time, become more and more centralized at Washington, it is highly probable that the number, variety and importance of federal corporations will correspondingly increase.

29. **Corporate name.**—Care must be exercised in selecting the corporate name not to select a name already in use or so similar to it as to be misleading or confusing. Articles of incorporation will not be approved if the name is unfairly similar. In many jurisdictions, corporations and joint stock companies whose members are not individually liable for the collective indebtedness are required to insert a distinctive notice to this effect in the company's name. This explains the employment of the term "Limited" by so many Canadian companies, for example. When the name, "The Ontario Woolen Co., Ltd.," is seen, the world is apprised at once of the fact that it is a limited liability company. Where this or some similar safeguard is not required the name indicates absolutely nothing. A very desirable reform in the general incorporation acts of many of our states would be the enactment of a section compelling the insertion in the company name of some distinctive and simple term indicative that there is no personal liability of the associates.

30. **Corporations de jure.**—Suppose the incorporators have faithfully complied with the provisions of the general act and their articles are duly recorded and a license to do business has been issued to them.

They have then become a corporation de jure, which might be defined as "one whose right to exercise a corporate function would prove invulnerable if assailed by the state in quo warranto proceedings."[49] That is, its existence is complete and perfect, and no private person, nor even the sovereign state itself, can challenge the fact of corporate existence. It is, as against the whole world, a new legal unit, an artificial juridical person.

31. **Same subject—Conditions precedent.**—The general incorporation acts of the different states prescribe a certain course to be pursued in organizing a corporation. It does not necessarily follow, however, that any departure from that course will prevent a corporation from becoming one de jure. Whether or not such departure will have that effect depends upon the nature of the provision which is omitted or violated. If it is an imperative or mandatory provision, a failure substantially to comply with it will prevent the incorporators from becoming a corporation de jure. Where certain acts are absolutely required to be performed before the corporation comes into existence, these are conditions precedent, and no corporation is created or can exist until those required acts are performed. As to what are mandatory provisions, the omission of which is fatal to corporate existence, the decisions are not in harmony.

The implied condition that there must be good faith in seeking corporate powers is mandatory. The other mandatory conditions generally are said to be:

[49] Capps v. Hastings Prospecting Co., 40 Neb. 470, 58 N. W. 956.

(1.) That there shall be a certain number of incorporators; (2.) written articles of agreement or incorporation; .(3.) usually requiring the names and residences of the subscribers to the stock; (4.) the naming of the place of business; (5.) the purpose or purposes of the corporation are required to be stated; (6.) that the articles of association be subscribed; (7.) acknowledged; (8.) filed as required by law. All of these things have been held to be matters of which the state may complain if not substantially followed by the incorporators.

Sometimes the subscription of the entire capital stock, or sometimes a subscription of a prescribed proportion thereof, is constituted an express condition precedent to de jure incorporation. Sometimes a certain requisite percentage of the capital is required to be paid in, also, before there can be de jure existence. Thus, in Illinois, the entire capital stock must be subscribed, and at least fifty per cent thereof duly paid in, before the Secretary of State will issue a certificate of complete organization to the incorporators.[50] On the other hand, the United States Supreme Court, in interpreting the general incorporation act of Mississippi, held that, thereunder, the subscription and payment of a given proportion of the capital stock were not conditions precedent to the company's de jure existence.[51]

32. **Same subject—Omission of directory provision.**—If the provision is *mandatory* in nature, a failure substantially to comply with its terms will

[50] Hurd's Rev. Stats. of Ill., chap. 32, § 4.

[51] Wells Co. v. Gastonia Cotton Mfg. Co., 198 U. S. 177, 49 L. Ed. 1003.

prevent the corporation from becoming one de jure. On the other hand, if the provision is merely *directory* in nature, then a failure to comply therewith, or a departure therefrom, will not carry with it that serious consequence. As to what constitutes a directory provision, it has been said: "Those directions which are not of the essence of the thing to be done, but which are given with a view merely to the proper, orderly and prompt conduct of the business, and by a failure to obey which the rights of those interested will not be prejudiced, are not commonly to be regarded as mandatory; and if the act is performed, but not in the time or in the precise mode indicated, it may still be sufficient, if that which is done accomplishes the substantial purpose of the statute."[52]

To illustrate: Suppose a state statute imposes personal liability upon the directors and officers unless the organization of the company has been perfected so that it is a de jure corporation. Suppose the statute requires that notice of the first meeting of the subscribers to the capital shall be given "by depositing in the postoffice properly addressed to each subscriber, at least ten days before the time fixed, a written or printed notice, stating the object, time and place of such meeting." This ten days' notice was waived, in one case, in writing, by the three sole subscribers, who met and, thereupon, proceeded to complete their organizing. The Supreme Court of Illinois held that this omission did not prevent the corporation from becoming one de jure, since the omission was not prejudicial and the statutory object was at-

[52] Butler Paper Co. v. Cleveland, 220 Ill. 128, 77 N. E. 99.

tained in substance. Said the court: "The only persons interested in the result to be attained are the subscribers themselves. We perceive no reason why such persons, where all agree thereto, may not waive the giving of the statutory notice, if the meeting is actually held, as the purpose of the statute in requiring the notices to be given has in such case been accomplished."[53] The mere fact that the word "shall" is employed in the statute does not necessarily render the provision mandatory. In the last analysis, the question is almost entirely one of statutory construction and public policy.

In the leading case of Newcomb v. Reed,[54] the court upheld the de jure existence of a corporation where the call for the first meeting had been signed by only one of the persons named in the act of incorporation, instead of by a majority of such persons, as required by the general statute. The provision was viewed as directory, merely, and not as mandatory. Non-compliance was, therefore, not fatal.

On the other hand, suppose the general incorporation act requires the insertion in the articles of incorporation of the number and names of the directors, and this is not complied with. It was held, under such facts, that the statutory provision was mandatory and that strict compliance was imperative, and essential to de jure existence.[55] Where the provision is mandatory, it is a condition precedent to de jure incorporation that it be faithfully, though not

[53] Butler Paper Co. v. Cleveland, 220 Ill. 128, 77 N. E. 99.
[54] 12 Allen 362 (Mass.).
[55] Reed v. Richmond S. R. Co., 50 Ind. 342.

necessarily literally, lived up to. And the courts will not concern themselves with whether, in its nature, the provision is wise or foolish.[56] That is a matter for the legislatures and not for the courts.

[56] People v. Montecito Water Co., 97 Cal. 276.

CHAPTER III.

IRREGULARLY AND DEFECTIVELY ORGANIZED CORPORATIONS.

33. **The de facto doctrine applied to imperfectly organized corporations.**—The de facto doctrine is not unique to the law of corporations. The Latin term "de facto," signifying "in fact," is used in contradistinction to the term "de jure," signifying "in law." During the Cuban war for independence, Cuba was a nation de facto, although not de jure. She was the former, because of the exercise by her, as a fact, of the essentials of sovereignty. Thus, Cuba was waging war, issuing orders, was the possessor of an army, had a legislature, and executive and judicial officers. But, though a nation de facto, she was not one de jure, because not recognized by the powers of the world and the law of nations, as such. In fact, but not in law, Cuba was, at that period, a sovereign nation. Later, Cuban independence became unquestioned and she was then recognized as a nation de jure. So it is with public officers. Suppose X, honestly believing that he had been lawfully elected mayor of his town, takes the oath of office and proceeds to fulfill the public duties of the position. In truth, Y was elected, as is subsequently discovered, and Y is thereupon installed in X's stead. Meanwhile X, who has been acting as mayor, was in the position of an officer de facto, though not de jure.

He (X) was exercising in point of fact, though not de jure, the official duties of the mayoralty. This doctrine finds expression, also, in the law of private corporations. Suppose that a corporation has failed to comply with the general incorporation act so as to be a perfect corporation, i. e., a corporation de jure. It may, nevertheless, under certain conditions (hereafter to be enumerated[57]), be regarded as a corporation de facto and be treated as a corporation, to practically all intents and purposes, as against the entire world except the state itself.

34. **Conditions of de facto corporate existence.**—It is essential to the existence of a de facto corporation that there be: (1) a valid law under which a corporation de jure might be organized, (2) a bona fide (honest) and colorable attempt to organize under this law, (3) a user and exercise of corporate powers.[58] Thus, where associates have honestly attempted to organize a corporation and proceed to act as though they had become a corporation, believing themselves to be such, the law regards them as a corporation; and no one but the sovereign state can successfully raise the question of the validity of their corporate existence. In other words, a slip-up or accidental omission will not necessarily vitiate corporate existence. It is true that the associates are not a corporation de jure and are liable, therefore, to be sued in an action of quo

[57] See § 34 of this article.

[58] Methodist Church v. Pickett, 19 N. Y. 482; Finnegan v. Noerenberg, 52 Minn. 239, 53 N. W. 1150, LEADING ILLUSTRATIVE CASES; Clark v. American Cannel Coal Co., 165 Ind. 213, 73 N. E. 1083, LEADING ILLUSTRATIVE CASES.

warranto, brought by the state, to test their right to do business as a corporation and to exercise corporate powers. But the corporate existence cannot be questioned by private individuals and they will not be permitted to raise the question of the legality of its organization. "The true doctrine is that it is sufficient to constitute a corporation de facto, as against one who has recognized its corporate existence, that there be a law under which it might exist de jure, an attempt in good faith to organize under such law, and a subsequent user of the assumed corporate powers."[59] A corporation de facto is regarded, for reasons of public policy, as a corporation, from the fact that it is acting as such under color of right in good faith. The development of the law on this topic has been rapid of late years in the direction of holding that the sovereign state which authorizes incorporation,—and it alone,—may challenge the legality of the exercise of corporate powers.

35. **Collateral attack.**—The doctrine outlined in the preceding section can be grasped more readily with the aid of a concrete illustration. A corporation sued to recover the possession of certain real estate detained by defendant. The answer attacked plaintiff's title, claiming that it was not legally organized and hence incapable of holding property. The Minnesota Supreme Court, assuming that there had been a failure fully to comply with the statute, held the same to be immaterial,[60] Mitchell, J., saying:

[59] Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, dissenting opinion of Marshall, J.

[60] East Norway Lake Church v. Froislie, 37 Minn. 447.

"The plaintiffs are at least corporations de facto. Such a corporation, at least where there is a law under which a corporation might have been legally formed with such power, is capable of taking and holding property as grantee as well as a corporation de jure, and conveyances to it are valid as to all the world, except the state in proceedings in quo warranto, or other direct proceedings to inquire into its right to exercise corporate franchises. And in an action by it to recover such property, no private person will be allowed to inquire collaterally into the regularity of its organization. This rule is not founded upon any principle of estoppel, as is sometimes assumed, but upon the broader principles of common justice and public policy. It would be unjust and intolerable if, under such circumstances, every interloper and intruder were allowed thus to take advantage of every informality or irregularity of organization."

This decision is sound. As said by the late Judge Brewer: "If the state, which alone can grant the authority to incorporate, remains silent during the open and notorious assertion and exercise of corporate powers, an individual will not, unless there be some powerful equity on his side, be permitted to raise the inquiry."[61]

36. **Necessity of a valid law.**—There cannot be a corporation de facto, at least on principle, where there cannot be one de jure. If there is no law under which a corporation de jure might exist, its non-existence may be set up even collaterally. It follows

[61] Pape v. Capitol Bank, 20 Kan. 440.

that there cannot be a corporation de facto under no law, or under a void or expired law. Thus, where the general law under which a corporation is organized or the special act authorizing the corporation, fixes a definite time when its corporate life must end, it is evident that when that time is reached, the corporation automatically dissolves and thereafter it cannot be even a de facto corporation, for want of any law authorizing corporate existence.[62] In other words, there is no longer any law "by virtue of which it might exist."

In several states, however, an unorthodox view prevails; and for the exercise of its franchises beyond the period for which the corporation was organized, the state alone may complain.[63] Similarly, where there is no law at all authorizing the parties to become incorporated there cannot, on principle, be a corporation de facto,[64] though authorities are not all in accord, some cases holding that, even then, its existence as a corporation cannot be questioned or attacked collaterally.

37. **Same subject—Incorporation under unconstitutional law.**—From what has been said in the preceding section, it should follow that there cannot be a corporation de facto under an unconstitutional statute, for such a statute is null and void, and a void law is, of course, no law. And a majority of our courts have so held.[65] On the other hand, several ju-

[62] Bradley v. Reppell, 133 Mo. 545, 32 S. W. 645, 34 S. W. 841.

[63] Bushnell v. Consolidated Ice Machine Co., 138 Ill. 67, 72, 27 N. E. 596.

[64] Eaton v. Walker, 76 Mich. 579; Davis v. Stevens, 104 Fed. 235.

[65] Brandenstein v. Hoke, 101 Cal. 131, 35 Pac. 562; Clark v. American Cannel Coal Co., 165 Ind. 213, LEADING ILLUSTRATIVE CASES.

risdictions of respectability have held otherwise.[66] On principle, these latter decisions, it is submitted, are unsound. Courts should not declare that there is a corporation de facto where there could not be a corporation de jure created.

38. **Necessity of bona fide attempt to organize.**—Where the general act required that the certificate of incorporation should be filed in the office of the Secretary of State, and a certified copy thereof or a duplicate original should be filed in the office of the clerk of the county in which the corporate office was to be located, the court held that the mere execution of the certificate was insufficient to create a corporation de facto.[67] The reason for this and other similar decisions is because there is not present a real attempt in good faith to comply with the requirements of the law. Courts differ among themselves as to how much must be done in order to create a corporation de facto. Some courts might regard a certain act required by statute as a condition precedent even to de facto existence and hold that, in its absence, not enough had been done. Others, under the same facts, might regard this as a mere slip-up, and would declare that it is in precisely such cases that courts should invoke the de facto doctrine. All courts agree, however, that some of the statutory steps must be taken in an honest attempt really to comply with the requirements of the law.

No court would hold, for instance, that the mere execution of a paper of association or incorporation,

[66] McCarthy v. Lavasche, 89 Ill. 270.

[67] Stevens v. Episcopal Church History Co., 140 App. Div. 570 (N. Y.).

which is not filed and does not become a public record, is sufficient. Under such circumstances, there would be no de facto corporate birth and the association's existence might be legitimately inquired into collaterally by any person, private or public, who is concerned or interested.

Where all steps have been taken except the payment to the state of the requisite fees, it has been held, that there is a de facto corporation. A well-known Colorado case holds, however, that the payment of fees is essential in order to wipe out "wild-cat" companies and is, therefore, "a condition precedent to the exercise of any corporate power," and non-payment is fatal alike to de jure or to de facto corporate birth.[68]

39. **Same subject—What is insufficient.**—There must be present the color, at least, of right. It is only for cases where this appears and merely a slip-up or unconscious omission has occurred, that the de facto doctrine should be invoked. Clearly, a mere agreement among the members to act as a corporation would be insufficient. On the other hand, the failure to have the certificate signed at the end thereof, as required by law, does not prevent de facto existence. It is a mere oversight, and if everything else has been duly attended to, there plainly appears the attempt to comply faithfully with the statute, which is the key-stone of a de facto corporation.

40. **Same subject—Effect of want of good faith.**—Where the element of good faith is wanting, the courts properly say that there is no de facto corpora-

[68] Jones v. Aspen Hardware Co., 21 Colo. 263, 40 Pac. 457.

tion. In a famous Massachusetts case, "the jury found that he (the incorporator) did not, in good faith, attempt to organize the corporation, but that he believed it to be a valid corporation." A unanimous court decided that his belief, in view of the jury's finding, was immaterial, that there was neither de jure nor de facto existence as a corporation, and that, therefore, defendant was personally liable for goods purchased under the veil of the corporate name.[69] This is good law and sound public policy. The perversion and abuse of justice otherwise would result.

41. **Necessity of corporate user.**—Let us assume that there exists a valid law under which incorporation could be had. Further, that there has been an honest and bona fide attempt, on the part of the incorporators, to organize under such law. In order to constitute the associates a de facto corporation, still a third element, namely, user, must appear. By user is meant an actual, open and notorious assertion and exercise by the associates of corporate powers. "If the law exists, and the record exhibits a bona fide attempt to organize under it, very slight evidence of user beyond this, is all that can be required."[70] There must affirmatively appear, however, some degree of proof of corporate user. In its absence, there will not be a de facto corporation.

42. **Partnership liability of associates.**—In some states the doctrine of the de facto corporation is not

[69] Montgomery v. Forbes, 148 Mass. 249, 19 N. E. 342, LEADING ILLUSTRATIVE CASES.

[70] Methodist Church v. Pickett, 19 N. Y. 482.

recognized and the associates therein are personally liable. The theory underlying these decisions is as follows: That the state has indicated what must be done in order to incorporate; that if this has not been done, there is no valid corporation in existence; that since there is no corporation duly created, individual liability still continues and the associates should be personally responsible. These decisions insist that the resort by the majority of our courts to the de facto doctrine is judicial legislation, is an unpardonable usurpation of power by the courts, and really is equivalent to creating corporations with the resultant immunity from individual liability, in utter defiance of what the legislature has declared is necessary. This point of view permits the corporate creditor to ignore the de facto existence of the associates as a corporation and allows him to proceed against the supposed stockholders as partners. The decided weight, especially of the more modern authorities, is contrary to this view. Some decisions which apparently so hold can be readily explained by reason of the existence of statutory provisions in the jurisdiction providing for individual liability to continue until a complete and perfect organization, i. e., a corporation de jure, has come into being.[71]

43. **Powers of a de facto corporation.**—In general, the powers of de facto corporations are the same as those of corporations de jure. Decisions in such important states as Missouri, New York and Ohio are disposed, however, to deny to a de facto corporation the power of exercising eminent domain, i. e., of

[71] See Loverin v. McLaughlin, 161 Ill. 417, 44 N. E. 99.

taking property by condemnation proceedings for their use. In a well-known decision so holding,[72] Judge Rappallo said: "In order to sustain proceedings by which a body claims to be a corporation, and as such empowered to exercise the right of eminent domain, and under that right to take the property of a citizen, it is not sufficient that it be a corporation de facto. It must be a corporation de jure. Where it is sought to take the property of an individual under powers granted by an act of the legislature to a corporation to be formed in a particular manner therein directed, the constitutional protection of the rights of private property requires that the powers granted by the legislature be strictly pursued, and all the prescribed conditions be performed."

The majority of states take the contrary view and say that de facto corporations are governed by the same principles exactly as de jure corporations, so long as the sovereign state acquiesces in their existence and their open exercise of corporate functions. They hold, accordingly, that the private citizen, whose property the de facto corporation has made application to condemn, cannot inquire into the lawfulness of its corporate existence.[73]

44. **The estoppel doctrine applied to imperfectly organized corporations.**—Suppose that A stands by and allows B to sell A's horse as his (B's) to C. A later seeks to replevy the horse from C. He cannot do so. We say that he is estopped (forbidden) to re-

[72] N. Y. Cable Co. v. Mayor, 104 N. Y. 1, 10 N. E. 332.

[73] Morrison v. Indianapolis R. Co., 166 Ind. 511, 76 N. E. 961, 77 N. E. 744, reviewing the cases.

claim the horse as his. He stood by and allowed B to sell the horse as though it were B's own property and said nothing. Having been at least instrumental in deceiving C, he (A) is not later allowed to assert his title; in other words, he is estopped. Having been silent when he should have spoken, A is forced to continue to keep silent when he wants to speak. Or, as the law says, an estoppel is raised against A. This doctrine is invoked frequently in cases where a party deals with a defectively organized corporation, e. g., enters into a contract with it, and subsequently seeks to repudiate his obligation because of the imperfection in the corporate organization. The law raises an estoppel against him and declares that having dealt with the concern on a corporate basis, it does not lie in his mouth to assert that the contrary is true; in other words, the law estops him. If it did not, the injury to the corporation would be unjust and inequitable. And the reverse is equally true. The defectively organized corporation is estopped to set up the invalidity of its organization as against one who dealt with it on a corporate basis.

45. **Conditions of corporate existence by estoppel.** —A concrete example will perhaps best illustrate when there is an estoppel to deny corporate existence or, as is sometimes said, the creation of a "corporation by estoppel." In the case of Gartside Coal Co. v. Maxwell,[74] the corporation was defectively created. An action was brought by one who had dealt with it as a corporation, against the shareholders, to hold them personally liable. The late Judge Brewer, who deliv-

[74] 22 Fed. 197.

ered the opinion, said in substance, that if the corporation had been challenged in a direct action by the state, its exercise of corporate powers would have been enjoined; but that where persons act in good faith and suppose they are members of a valid corporation and transact business as such, and their corporate existence has not been attacked by the state, they cannot be held liable as individuals. If a person deals with what he and all persons suppose is a corporation, he cannot later turn around and say, "Well, I dealt with this supposed corporation; I thought it was a corporation; I trusted it as such; but, by reason of failure to legally incorporate, there is no legal corporation; therefore, I will hold the stockholders personally liable." Judge Brewer proceeded to say that this could not, and should not, be done. Nor could the stockholders, if sued as a corporation by the creditor dealing with them as such, set up the defects in their corporate organization as a defense to liability. It would not equitably lie in their mouths to urge that there is no corporation and that they are not liable as such.

In Snyder v. Studebaker,[75] P sued D to recover certain land. P had originally conveyed the land by deed to a railroad company, which, in turn, had deeded it to D. P claims that, as his grantee, the railroad company had no valid corporate existence at the time of his deed to it, that no title passed from him; that, therefore, D got no title and that he (P) is entitled to the land. Held, against P. Said the court: "A party who has contracted with a corporation, as

[75] 19 Ind. 462.

such, is, as a general proposition, estopped by his contract to dispute the existence of the corporation at the time of the contract." A dictum in this case was to the effect that the estoppel is limited to matters of fact and that it does not extend to matters of law. This doctrine is generally regarded today as unsound. Moreover, it is contrary to the weight of authority.

46. **Same subject—Who are estopped?**—First, the pretended corporation is estopped as against those dealing with it to deny its corporate existence. Second, persons who have dealt with the supposed corporation on a corporate basis can hold it as such and can, on the other hand, be held by it as such. Third, wrongdoers, whether tortious or criminal, cannot question the legality of corporate existence. Thus, under a criminal prosecution for embezzlement from a corporation, the court properly held that it was sufficient to show that the money stolen was the property of a concern doing business on a corporate basis. A decision such as this, however, rests more properly on the de facto than upon the estoppel doctrine, for it is difficult to discover therein the elements of an equitable estoppel. Fourth, the organizers and officers of the supposed corporation are, of course, forbidden to raise the issue of its organization according to law. Finally, the associates inter se, i. e., among themselves, are very properly estopped. Thus, where X was injured and thereupon sued his associates individually in a mutual benefit association, it was correctly held that he could not hold them personally liable, though the company was concededly

estopped himself from questioning its corporate organization by making out a note in favor of it as a corporation.

48. **Limitations of the estoppel doctrine.**—As has been seen, some jurisdictions recognize the possibility of extending the doctrine of estoppel to cover cases where there is not even de facto corporate existence. But a number of states apparently confine the use of the estoppel doctrine to instances where there is at least a de facto corporation. In these latter jurisdictions, there is obviously no need for the estoppel theory at all, as the de facto doctrine explains all of the cases. The theory of these cases is that "it would be extending the doctrine of estoppel to an extent, not justified by the principles of public policy, to allow it to operate through the conduct of the parties concerned, to create substantially a de facto corporation, with just such powers as the parties may by their acts give to it." In other words, they feel that such a course would mean to substitute the dealings of the parties in the place of compliance with the requirements of the incorporation laws, which would be not only in opposition to the law, but against its policy.[80]

In some cases, the decision can only be explained, moreover, on the de facto doctrine. Thus, where X trespasses wrongfully on the lands of a railroad company, there is manifestly no dealing between them on a corporate basis nor are there present the elements of an estoppel; yet the courts hold, with practical unanimity, that for the purpose of protecting its

[80] Boyce v. Trustees, 46 Md. 359.

property from tort-feasors, it suffices to show a corporation de facto.[81] This plainly goes to prove that, "The theory that a de facto corporation has no real existence, that it is a mere phantom, to be invoked only by that rule of estoppel which forbids a party who has dealt with a pretended corporation to deny its corporate existence, has no foundation, either in reason or authority. A de facto corporation is a reality. It has an actual and substantial legal existence. It is, as the term implies, a *corporation.*"[82] In other words, the estoppel doctrine has marked limitations. There are numerous cases which cannot be squared with it, and in the solution of which the doctrine of the de facto corporation must necessarily be invoked. To a certain extent, of course, the de facto corporation and the so-called corporation by estoppel inevitably overlap. What the courts, however, are coming to hold, more and more, is this: that, in the last analysis, the soundest policy and the safest guide is to adopt the principle that only the sovereign state, and not mere private persons, can challenge the existence of a valid corporate organization.

[81] Cincinnati, etc., R. Co. v. Danville, etc., R. Co., 75 Ill. 113; National Society v. American Surety Co., 56 Misc. 627 (N. Y.), 107 N. Y. Supp. 820.
[82] Society Perun v. Cleveland, 43 Ohio St. 481, 3 N. E. 357.

CHAPTER IV.

PROMOTION OF CORPORATIONS.

49. **Promoters defined and classified.**—"A promoter has been defined to be one who brings about the incorporation and organization of a company; who brings together the persons who become interested in the enterprise; who aids in procuring subscriptions, and sets in motion the machinery which leads to the formation of the corporation itself."[83] It is as much a business as it is a legal term and sums up, in one word, the familiar steps by which corporations are brought into existence.

Promoters may be conveniently grouped into two classes: (1) statutory, (2) self-constituted. An instance of the former are the incorporators or commissioners who begin the organization of the company, as in Illinois,[84] under the general act. An instance of the latter are the financiers who induce several competing concerns to consolidate and whose reward comes in the shape of a large block of stock in the new corporation as compensation for their services.

50. **Fiduciary relation to the corporation.**—Every person, acting by whatever name in the forming and establishing of a company at any period prior to the birth of the company is legally regarded as occupying

[83] The Telegraph v. Loetscher, 127 Iowa 383, 101 N. W. 773, LEADING ILLUSTRATIVE CASES.

[84] See § 26 of this article.

a fiduciary relation towards the corporation. He is subject, therefore, to the disabilities of a fiduciary, i. e., one who occupies a position of trust and confidence. He is guilty, for example, of a breach of trust if he sells property to the corporation without informing it that the property belongs to him, or if he accepts a bonus or commission from one who sells property to the corporation. The dealings of the promoter must be like those of a trustee—strictly open and fair. No advantage must be taken of the unborn corporation. Hence, if the promoters purchase property, while engaged in floating the company, they must let the corporation have it at the same price which they paid for it. This results from the trust relation in which they stand. This does not mean that a promoter cannot sell to the corporation. He can, and often does. But he must make full and fair disclosure of all essential facts to the directors or managers of the corporation who act for it. The sale is invalid if the directors or managers were put into office by the promoter himself and are his mere tools and dummies. Under such circumstances, there is no true disclosure. The directors or managers must be capable of exercising sound, independent judgment.

51. **Same subject—Necessity of full disclosure.**—In a leading English case,[85] the extent of this duty of full disclosure was ably considered. The owners of the island of Sombrero constituted themselves into a syndicate to sell the island and, to that end, proceeded to form a corporation themselves to take it off their hands. A memorandum of association was

[85] Erlanger v. New Sombrero Phos. Co., (1878) L. R. 3 App. Cas. 1218.

drawn up and signed by seven nominees of the syndicate. A contract of sale between the syndicate and the corporation was then made. The directors of the corporation, who authorized the purchase, either held their shares only nominally or had not adequate knowledge of the facts or were mere dummies of the syndicate. The stockholders, who purchased shares in the company, never ratified the action of the directors, and, subsequently, brought suit to set aside the sale and have the purchase price refunded. It was so decreed below and affirmed on appeal for two main reasons: (1) the corporation never had an opportunity of exercising, through competent and independent directors, a fair judgment; (2) the sale was brought about by the schemes and unfair conduct of the promoters, i. e., the members of the syndicate, themselves. The learned court, indicating that promoters stand in a fiduciary relation to a company they are about to form, pointed out that if they wish to sell to it, they must provide it with a competent and impartial board of directors who know the facts and who can exercise a fair, unbiased judgment. Obviously, when a corporation is formed to buy from the promoters as vendors, the interests of the promoters and of the corporation clash, and this is still another reason why the promoters must act squarely and fairly. The consent of dummy directors and stockholders should be regarded as a nullity, and it is usually so held,[86] though a decision of the United

[86] Mason v. Carrothers, 105 Me. 392, 74 Atl. 1030; Old Dominion Copper Co. v. Bigelow, 188 Mass. 315, 74 N. E. 653, followed, 203 Mass. 159, 89 N. E. 193.

States Supreme Court is difficult to reconcile with this statement.[87]

52. **Same subject—Liability for secret profits.**—A promoter is liable to account to the corporation for secret profits made and pocketed by him. While such conduct on his part may, in a proper case, afford ground for rescission, the corporation may, if it wishes, proceed to affirm the transaction and to claim all the advantages thereof, including any secret bonus or profit gained by the promoter. In Yale Gas Stove Co. v. Wilcox,[88] F and W agreed that W should promote and organize a corporation, to which F should transfer certain patents at twice the price which F was really willing to take for them and $5,000 worth of shares of stock as well. Of this cash and stock, W was to receive one-half. It was held that the company was entitled to recover from W all that he had thus received.

In Hebgen v. Koeffler,[89] suit was brought by stockholders on behalf of the corporation to recover of the promoters certain alleged fraudulent profits. They had purchased certain realty on behalf of the corporation ostensibly for $55,000, but really for $31,000, the promoters pocketing the difference. In holding the promoters liable, the Wisconsin Supreme Court said: "A person (promoter) so circumstanced stands in a relation of trust and confidence to all his bona fide associates, and holds all the profits secretly made for the common benefit of all engaged in the com-

[87] Old Dominion Copper Co. v. Lewisohn, 210 U. S. 206, 52 L. Ed. 1025.
[88] 64 Conn. 101, 29 Atl. 303.
[89] 97 Wis. 313, 72 N. W. 745.

mon enterprise, in proportion to their respective interests."

53. **Relation to subscribers—The prospectus.**—Promoters are ordinarily liable for secret profits only to the corporation. Sometimes, however, a fiduciary relation between them and the subscribers may also exist. If it does, then the promoters are responsible to them, also, in the event of their failure to make full and fair disclosure. Promoters are liable to purchasers of stock for false statements made with regard to the properties and condition of the company. Mere "puffing" phrases or predictions, or expressions of opinion and judgment, must be carefully distinguished from mis-statements of fact. It is only the latter which constitute the basis of an action for deceit.

A promoter, who knowingly issues or sanctions the circulation of a false prospectus containing untrue statements of material facts naturally calculated to mislead the public and to induce it to purchase the corporate stock or other securities, is unquestionably responsible to all injured thereby.[90] Where there are a number of promoters, all are liable for the fraud of an agent employed by them to market the securities, without reference to their personal guilt or innocence.[91]

The document prepared by the promoters in order to acquaint the investing public with the merits of the proposed project is called the "prospectus." It must be fairly worded, and must refrain from misleading

[90] Morgan v. Skiddy, 62 N. Y. 319.
[91] Downey v. Finucane, 205 N. Y. 251.

or tricky phrases even though these may not be positively false. The test is not always whether there are any specific allegations of fact proven to be false, but rather "whether taking the whole thing together was there a false representation." The highly colored prospectus of the swindling enterprise has tended to bring many absolutely legitimate promotions into disrepute. From a practical standpoint, extravagant phraseology and too high-sounding promises, while perhaps not actionable, defeat themselves. The investing public has been fooled too often, and while credulous persons here and there may still be cheated, the world as a whole, at least in these respects, is growing wiser. Besides, our jails and penitentiaries harbor not a few convicts who permitted their glib tongues and pens, operating upon their fertile imaginations, to run away with the facts of the case.

54. **Compensation of promoters.**—In most jurisdictions, a promoter is not entitled to be compensated for services rendered *prior* to the birth of the corporation. A right of recovery against a corporation for anything done before it comes into existence, said the Supreme Court of Illinois, "does not appear to rest on any very satisfactory legal principle."[92] It seems more reasonable to regard any services performed or expenses incurred prior to the organization of the company as gratuitously rendered, in view of the general good as well as the private gains expected to result from the object of the corporation. Besides, in the absence of a statute, it would seem unjust to

[92] Rockford, etc., R. Co. v. Sage, 65 Ill. 328. See also, Gent v. Mutual Ins. Co., 107 Ill. 652, LEADING ILLUSTRATIVE CASES.

stockholders, who subscribe and pay for stock in a company, that their property should be subject to the burden of claims which they had absolutely no voice in creating. It is soon enough for corporations to enter into contracts encumbering their property when they are once duly formed according to law and have selected their chosen and presumably impartial and competent directors to conduct their business.

For services and expenses rendered before organization, which, subsequently, the duly organized company accepts and receives the benefit of, and expressly promises to pay for, the company is liable and the recovery may be had by virtue of such express promise. There is, however, in the absence of such express promise no right of recovery upon any implied promise resulting from the facts. A few cases sanction such a recovery,[93] but they are in a decided minority. In Kentucky, it was recently held, though, "that a corporation is, by an implied contract, liable for such or any services rendered for the use of the corporation as are necessary to its formation, or may be necessary to be done by it, after its incorporation, in furtherance of its corporate business;" and a judgment in favor of plaintiff, a promoter, for services rendered in organizing a bank, securing and soliciting stock, superintending the work of building, and framing the papers of incorporation, was permitted to stand.[94] This is not the usual view. That a corporation should have a full and complete organization and existence as a legal entity before it can enter into any

[93] Low v. Connecticut R. Co., 45 N. H. 370.
[94] Farmers' Bank v. Smith, 105 Ky. 816, 49 S. W. 810.

kind of a contract or transact any business, would seem to be self-evident. As well say that an unborn child may enter into a contract, or that its parent may bind it by contract. And to argue that because the corporation has obtained the advantage of the promoters' work done before the formation of the company, it is, therefore, equitably liable to pay for the cost of that work, is a contention that only very recently seemed wholly unsound to a learned and able English judge.[95]

For their services rendered *subsequent* to incorporation and organization the corporation, of course, is liable to its promoters. In a Vermont case, this was extended to where the services were performed subsequent to the act of incorporation but prior to perfecting the organization of the company.[96]

55. **Corporate rights and liabilities on contracts of promoters.**—One of the most important questions in the entire law of private corporations is the extent to which a corporation is liable upon a contract entered into, on its behalf, by its promoters, before it has been organized. The first question is whether the corporation is liable at all, and the second, and hardly less important question, is to determine in what form or forms of action it is liable. Since the corporation is not a legal unit until it has become organized, it stands to reason that it cannot be a party to a contract made for it by its promoters. Does this mean, however, that the corporation can never be held liable thereon? Let us take a concrete instance. X and Y,

[95] In re English, etc., Produce Co., (1906) 2 Ch. Div. 435 (Eng.).
[96] Hall v. Vermont & Mass. R. Co., 28 Vt. 401.

the promoters of a proposed telephone company, order on its behalf an exchange to be built and the requisite equipment. The corporation is duly organized. It takes over and uses the exchange and the equipment. Is it liable for the contract price? Some of our courts answer the question in the affirmative and declare that by retaining and using the articles, upon organization, it adopts the agreement and becomes liable to pay the contract price. In other words, these courts declare that a contract made by the promoters of a corporation on its behalf may be ratified, adopted, taken over, by the corporation when organized, and that the corporation is then liable both at law and in equity on the *contract* itself.[97] To hold it on the contract, however, there must appear an express resolution of the board of directors, an adoption, or some other act by the corporation, subsequent to its organization, manifesting its intention to be bound. In a number of the state jurisdictions statutes expressly provide that the corporation shall be liable for all expenses incurred in organizing it.

On the other hand, in England it has been held in the more recent cases that, in the absence of a charter or statutory provision, a contract made by the promoters of a corporation on its behalf, before incorporation, is a nullity and that the corporation cannot ratify or adopt it and thus make it binding upon it after incorporation. They also hold, however, that an action on a contract implied in law (*quasi ex contractu*) may be maintained against it, if the corpora-

[97] Tuttle v. Tuttle Co., 101 Me. 287, 64 Atl. 496.

tion accepts and retains the benefits of such a contract.[98] A similar view thereof prevails in Massachusetts and in a few of the other American jurisdictions.[99]

56. **Same subject—Ratification or adoption.**—Assume A is the promoter of a corporation to be thereafter formed. B, an outsider, contracts with A to sell to the corporation certain machinery. Assume the contract to be so worded that it is on behalf of the corporation. Can the corporation, when formed, sue B? One cannot call the promoter the agent of the corporation, for the corporation is not even in existence at the time the contract is made. The corporation is not the principal of the promoter. Consequently, talk of ratification of the contract by the corporation, when it comes into existence, is vain and foolish. In no proper sense of the term can there be a "ratification" of the contract by the corporation, because the cardinal principle of a ratification is lacking. For ratification always implies the existence of a principal on whose behalf the contract was made when it was entered into. In these cases, the "ratifier" was not yet legally born at that time and hence this essential requisite of ratification is absent. Despite this, some cases loosely declare that there can be a ratification. What these cases really mean to say is that the corporation may, if it chooses, "adopt" such a contract made for it by its promoters. What is called "adoption" is substantially the making of a new contract as of the date of the adoption. A nova-

[98] Kelner v. Baxter, L. R. 2 C. P. 174 (Eng.).
[99] Pennell v. Lothrop, 191 Mass. 357, 77 N. E. 842.

tion really takes place, the corporation being substituted in the place of its promoters. It is substantially the making of a second contract, dating from the time of the adoption.[1] It is far more correct to speak, therefore, of an adoption or novation of the contract by the corporation than of its ratification. In any event, while a corporation is not bound by engagements made on its behalf by its promoters before its organization, it may, after incorporation, make such engagements its own contracts. Such adoption need not necessarily be formal, but may also be legitimately inferred from acts or acquiescence on the part of the corporation or its agents. Thus, where promoters promised that if a certain bonus were paid to a corporation to be formed it would build its road between certain points and carry coal at a certain rate, and the corporation, upon its formation, accepted the bonus, it was held bound to fulfil the duties and obligations of the contract.[2] In other words, if the corporation with a knowledge of the facts, accepts the benefits of a contract made for it by its promoters, it must take it *cum onere,* which means, with the burdens also. And, as has been seen,[3] some very respectable jurisdictions refuse, under any conditions, to hold the corporation liable on the contract itself, and make it respond only to the extent to which it has been unjustly enriched in an action brought in quasi-contract, i. e., on a fictitious contract implied by the law.

[1] McArthur v. Times Printing Co., 48 Minn, 319, 51 N. W. 216, LEADING ILLUSTRATIVE CASES.

[2] Weatherford, etc., R. Co. v. Granger, 86 Tex. 350.

[3] See § 55 of this article.

57. **Same subject—Quasi-contractual obligation for benefits retained.**—Even in those jurisdictions which refuse to hold a corporation liable upon contracts made for it by its promoters, a corporation is not permitted to retain and use the benefits conferred upon it, under such contract, without making due compensation for them. In an English case,[4] J and P, lawyers, rendered services to a company before its formation, the benefits being retained after it had been chartered. They sued on the contract to recover the agreed compensation. Their claim on the contract was disallowed, but without prejudice to their right to sue, if they saw fit, in a quasi-contractual action to recover the reasonable value of their services. This is but fair. Whether the corporation can logically be held in contract or not, surely where it retains the benefits, it should be made to pay.

58. **Personal liability of promoters on contracts.**—The personal liability of the promoters on the engagements which they enter into depends upon the form and terms of the contract. If the promoters bind themselves personally they are liable thereon. The only circumstance which can relieve them under such circumstances from liability is the occurrence of a novation after the corporation is formed. By this is meant a substitution, with the other party's consent, of the liability of the corporation in the stead and place of that of the corporate promoters. Nothing short of this will relieve them from continued personal liability.

On the other hand, suppose the promoters draw the

[4] In re Empress Eng. Co., L. R. 16 Ch. D. 125 (Eng.).

contracts in such a manner as to preclude their personal liability and provide that the proposed corporation alone shall be liable. Then the other party can look to the corporation, and to it alone. In Landman v. Entwhistle,[5] P sued D as one of the promoters of a projected railway company to recover the value of his engineering services. It appeared that at a meeting where P was present, it had been distinctly agreed that the promoters were not to be liable personally for expenses to be incurred in and about the new company. A non-suit of P was affirmed on appeal. This result is correct. P undertook to work, not for the promoters, "but looking to the chance of the scheme succeeding." Had it proven a success, he would no doubt have been paid. Persons rendering services for promoters should, therefore, if possible, seek to obtain a personal assurance of payment from them. The promoters' interest, on the other hand, is plainly to avoid having to do this if they possibly can.

As between themselves, and within the limits of their joint enterprise, the promoters are substantially partners for the time being and liable, as such, for the acts of each other. In some cases, however, their liability is assimilated rather to that of joint adventurers.

[5] 7 Exch. 632 (Eng.).

CHAPTER V.

SUBSCRIBERS AND STOCK SUBSCRIPTIONS.

59. **The agreement of association.**—The contractual agreement between the incorporators is essential in the formation of a corporation. The individuals must first of all agree that they wish to associate and act as a legal unit. Once they have so agreed, then and only then, is the assent of the sovereign, approving and sanctioning their agreement, necessary. A subscription agreement to the capital stock of the proposed company is, therefore, essential. By capital stock we mean the fund dedicated by the associates to the corporate enterprise and with which business is to be commenced. This contract may be a common law agreement or statutory; in the latter case, compliance with the local statute is requisite.

60. **Who may subscribe.**—Since the agreement of association is but a form of contract, it follows that the associates must be persons capable of contracting. Otherwise, their subscriptions are worthless in the eyes of the law. An infant may subscribe for shares of stock in the company, but like all other contracts of an infant, this is voidable and the child can disaffirm on attaining its majority. A married woman at common law could not subscribe, for her subscription contract would be void; today, however, the married woman's disabilities have been almost entirely removed by statute, and it follows that her subscription

would be valid. In the absence of constitutional provisions to the contrary, the national government or a state may, by permission of the legislature, subscribe for stock. By the weight of authority, a corporation cannot be an incorporator or subscribe for stock. The statutes contemplate the association of natural, not of mere artificial, persons. The power of a corporation to subscribe is, therefore, generally denied. However, the fact that some subscribers were corporations, unauthorized to subscribe, will not defeat liability on a stock subscription.

61. **Subscriber distinguished from stockholder.**—Just as a contract to sell differs from a sale, so a contract to subscribe differs from a subscription. A contract to subscribe, like the contract to sell, looks to the future; it is executory. The subscription, on the other hand, resembles the bargain and sale in that it is present and does not take effect merely in the future. The effect of a contract to subscribe is to create the person signing such an agreement, a subscriber merely. Whereas, the effect of signing an agreement of present subscription is to constitute the signer a stockholder in the corporation when organized.

In Thrasher v. Pike County Railroad Co.,[6] the agents of the company, before its organization, agreed and promised to receive T's subscription of $3,000 to the capital stock of the company. T, in consideration of this promise, agreed in writing that he would subscribe to the stock of the plaintiff corporation the sum of $3,000 when the books were opened for subscriptions. The plaintiff claimed that the subscription

[6] 25 Ill. 393, LEADING ILLUSTRATIVE CASES.

books were opened, of which defendant had notice, that T's subscription was then due, but that T refused to pay same. The court held that T's promise did not make him a stockholder and that the plaintiff corporation, in its suit to recover for T's failure to subscribe, could obtain as the proper measure of damages only the difference between the market and par value of the stock at the time of T's breach. The plaintiff had treated the agreement sued on as a subscription, but the court said that "this we do not think is a fair view of the defendant's liability upon his promise, if one was made to the plaintiff. His undertaking is to subscribe a certain amount of stock when the subscription books should be opened. This promise does not make him a stockholder, and as such liable to calls." The courts in Pennsylvania and Kentucky have placed similar interpretations upon such agreements, but a recent Kentucky decision apparently repudiates this line of reasoning.[7] In a number of jurisdictions, the distinction is not recognized, or if recognized, is disregarded,—no distinction whatever being made between agreements to subscribe for stock, on the one hand, and present subscriptions, upon the other.

62. **Necessity of stock certificate.**—A stock certificate is a writing which evidences the shareholder's interest in the corporation of which he is a member. It is not the stock itself, but it is simply authentic evidence of title to stock. A person may be a shareholder though he never chooses to take out a certificate of stock. In point of fact, millions of dollars

[7] Bullock v. Falmouth, etc., Turnpike Co., 85 Ky. 184, 3 S. W. 129.

worth of capital stock are unquestionably held without any certificate of stock, or if certificates chance to have been made out, without their having ever been delivered. Parties may, and often do contract, however, that stock shall not be paid for until certificates therefor have been issued and delivered or tendered.

In a New York case,[8] an action was brought against the defendant, as a stockholder, to charge him with indebtedness of the corporation. It was proved at the trial that the defendant was one of the original incorporators and that he subscribed for fifty shares of stock but did not pay for them; that he was a director and officer of the corporation and actively participated in its management. No certificate was ever issued. The court held the defendant liable.

In another case, the Supreme Court of the United States held that a subscription to stock in a national bank, full payment, and the entry of the subscriber's name in the bank's register of shareholders, constituted the subscriber a stockholder, though no stock certificate was ever taken out.[9] Justice Bradley said: "The only question to be considered, therefore, is whether the fact that the defendant in error did not call for and take her certificate of stock made any difference as to her status as a stockholder. We cannot see how it could make the slightest difference. * * * It was her certificate. She could have compelled its delivery had she been refused. Whether she called for it or not was a matter of no consequence whatever in reference to her rights and duties." This

[8] Wheeler v. Millar, 90 N. Y. 353.

[9] Pacific Nat. Bank v. Eaton, 141 U. S. 227.

is sound. The scrip, or certificate, is not the stock, and possession thereof is consequently necessary, in no respect, in order that one may qualify as a stockholder.

63. **Nature of the subscription contract.**—The courts are not in accord as to the exact nature of a contract of subscription to the capital stock of a corporation to be formed. (1) Some courts regard it as a binding contract between the subscribers from the moment it is entered into. (2) Other courts regard it as a binding contract between the subscribers and also as a series of offers to the proposed corporation which it can accept when it comes into existence. (3) Still other courts hold that there is no binding contract between the subscribers at all, but that the subscriptions are merely so many offers to the proposed corporation which it may accept or reject when it is born.

The third view which regards the subscription as a mere offer to the projected corporation is supported by the weight of recent authority. In Hudson Real Estate Co. v. Tower,[10] the defendant withdrew his subscription before the corporation had become organized and had accepted his subscription. It was insisted that he was bound. The court held that when the defendant signed the subscription paper it was not a contract, for want of a contracting party on the other side. Such a subscription becomes a contract with the corporation when it has become organized and has accepted the subscription. In this way, the objection of the want of a proper contracting party

[10] 156 Mass. 82, 30 N. E. 465.

is avoided. In some cases, the mere birth of the corporate entity is regarded as the requisite acceptance of the subscription offers; but the better considered cases hold that there must be some affirmative evidence of an acceptance, by corporate act or resolution, after the entity has been born. Until the organization of the corporation the subscription is a mere offer and like any other unaccepted offer, it may be lawfully withdrawn before acceptance.

The first view is taken by several cases. Thus in an early English case where the subscriber sought to withdraw, it was held that he could not do so without the consent of all those with whom he had become engaged in the undertaking, and the court held that there existed a mutuality of contract binding as between the various co-subscribers from the outset.[11] Several American decisions take the same view of the matter.

In the leading Minnesota case of the Minneapolis Threshing Machine Co. v. Davis,[12] the second view is adopted. The theory is this: A subscription by persons to the stock of a corporation to be thereafter formed by them constitutes a contract between the subscribers themselves to become stockholders when the corporation is formed upon the terms set out in the agreement, and as such, is binding and irrevocable from the date of the subscription. But, the subscriptions also operate in the nature of so many continuing offers to the projected corporation, and upon acceptance, become as to each individual subscriber, binding

[11] Kidwelly Canal Co. v. Raby, 2 Price 93 (1 Eng. Ex.).
[12] 40 Minn. 110, 41 N. W. 1026.

contracts between him and the corporation. Such subscriptions are thus treated not only as mutual promises among the subscribers as toward each other, but also as a series of proposals to the projected corporation whose organization is in contemplation.[13]

64. **Same subject—Right to withdraw.**—Under the third view, as has been seen, the subscription is a mere offer—and nothing more—until the organization of the corporation. The subscriber may withdraw at pleasure until that time. It is absolutely open to him to do this. This is not on the ground that there is no sufficient consideration. A subscription under seal would do away with doubts on that score. It is rather for the reason that until the corporation is organized the subscription cannot take effect as a binding contract, because the contemplated party to the contract on the other side, namely, the corporation, is not yet in existence. On this ground, there being no contract, the whole agreement is incomplete, and since there is no contract, the party subscribing may withdraw. The revocation must be communicated to the corporation, though a notification to the promoters who solicited and obtained the particular subscription is regarded as sufficient.

It also follows, under this line of reasoning, that the death or insanity of the subscriber would operate as a revocation of his subscription. This results from the well settled principle that an offer lapses with the death, natural or civil, of the offeror.[14]

Under the first and second views of the nature of a

[13] See Nebraska Chicory Co. v. Lednicky, 79 Neb. 587, 113 N. W. 245.
[14] Beach v. First M. E. Church, 96 Ill. 177.

subscription agreement, the subscriber is bound, however, at least to his fellow subscribers, from the time the agreement is made.[15]

65. **Same subject—Effect of statutory provisions.** In many jurisdictions the subject is governed by statutory provisions. The common law rules, however, in respect to the rights and liabilities of subscribers for stock are binding "except as they may have been changed by statute, for where the statute prescribes the method of subscription, a subscription made in any other way cannot be enforced."[16] In Coppage v. Hutton,[17] the receiver of an insolvent corporation sued to recover a subscription which he alleged that H had made to the capital stock of the company. The statute required that the persons who desired to organize a corporation shall "make, sign, and acknowledge before some officer capable to take acknowledgement of deeds, a certificate in writing," setting forth certain facts. H's defense was that his promise was not binding because only seven of the eighty-three signers acknowledged the certificate. Clearly the mere signing of the paper was not sufficient to complete the obligation of the subscribers. In order to make the articles of association valid and effective, all the signers should have acknowledged them, as the statute required. Hence the subscription was incomplete, did not comply with the statute, and the defense prevailed. As H did not acknowledge the instrument as the law required, he did not become a stockholder. If

[15] Hughes v. Antietam Mfg. Co., 34 Md. 316.

[16] Planters, etc., Packet Co. v. Webb, 144 Ala. 666, 39 So. 562.

[17] 124 Ind. 401, LEADING ILLUSTRATIVE CASES.

H were insisting that he was entitled to the number of shares set opposite his name, it is quite clear that the corporation could have successfully resisted his claim. The reverse proposition is equally true and H cannot be held liable as, or regarded as a stockholder.

In New York and several other jurisdictions, the statute requires a certain specified proportion of the stock subscribed for, to be paid in upon organization. Where this is not done, the subscription is null and void. In a recent case,[18] it was held that the giving by the defendant of his note as payment for ten per cent of the value of certain shares of an original issue of stock subscribed for by him, was not the equivalent of the cash payment of ten per cent required by the statute. The transaction amounted merely to a promise to pay and not to a payment. Therefore, the defendant's subscription was not binding upon him. The failure to comply with the statutory requirement vitiated the subscription. The reasoning which rejects notes would, of course, reject uncertified checks as well.[19] In several states, Louisiana apparently, for example, this result is not reached under similar statutes. The payment is regarded as required for the corporate benefit and may be waived, if desired. This view would seem to ignore the legislative intention to provide the new corporation with funds from the very outset.

66. **Implied conditions to liability of subscribers —De jure incorporation.**—Where A agrees to take fifty shares of stock in a corporation to be formed,

[18] Hapgoods v. Lusch, 123 App. Div. 23 (N. Y.), 107 N. Y. Supp. 331.
[19] Excelsior Grain B. Co. v. Stayner, 25 Hun. 91 (N. Y.).

plainly a condition is implied that the company shall be a valid or de jure incorporation. A legal and effectual formation of a corporation for the specified purpose would be a condition precedent to his obligation to take the stock. A would not be bound to invest his capital in the stock of a corporation not legally formed. The subscribers might be willing to invest their money and take their chances of the investment being remunerative, if no further liability would attach to them than that of stockholders in a de jure corporation, when they would not have even dreamed of risking the same money for the same purpose in a partnership or a de facto corporation, where their assumed liabilities would, of course, be far greater than in a de jure corporation. A fair construction of the promise of A is that he agrees to become a stockholder in a de jure corporation and not in a de facto corporation or a partnership.[20] There is no estoppel against A, for the subscription to stock does not purport to be made with an existing corporation and does not, therefore, estop the subscriber afterward to deny the valid existence of the corporation in a suit upon the subscription.

However, where the subscriber agrees to take stock *after* the company has been established and enters into the contract after its formation, he precludes himself from setting up the invalidity of its organization as a defense to an action upon his subscription contract. This rests upon the ground that by contracting with it, he had recognized its existence as a corporation. "No such ground could be assumed

[20] Capps v. Hastings Pros. Co., 40 Neb. 470, 58 N. W. 956.

where the contract was made *before* the formation of the corporation, and was conditioned upon its formation."[21] There is thus a marked distinction as to the liability of parties for subscriptions to an already existing corporation or to an existing association which assumes to be and is acting as a corporation, and the liability for subscriptions made by parties for the purpose of organizing thereafter a new corporation from among the subscribers. In the former instance, there exists an estoppel to set up as a defense that the existing company is not a corporation de jure. In the latter instance, there exists no estoppel, for it stands to reason that there was no dealing on a corporate basis and that the company was not yet in existence.

67. **Same subject—Subscription of full amount of authorized capital.**—Another implied condition of great importance is that where the total capital stock and the number of shares are fixed in the articles of association or preliminary certificate, no calls or assessments on payment for said shares can validly be made against a subscriber until all the shares have been taken. In the absence of statutory modification, this rule holds generally true. The reason is that the success of the enterprise and the profits to be realized therefrom may entirely depend upon having the full amount of the capital stock taken up.[22] This is not an arbitrary rule but is founded upon a plain dictate of justice.[23] Where a man subscribes a share

[21] Dorris v. Sweeney, 60 N. Y. 463.
[22] Hughes v. Antietam Mfg. Co., 34 Md. 316.
[23] Stoneham Branch R. Co. v. Gould, 2 Gray 277 (Mass.).

to a capital stock to consist of one thousand shares, in order to carry on some proposed enterprise, he binds himself to pay a thousandth part of the enterprise. If only three hundred are subscribed for, he would be held, if liable to assessment, to pay a three hundredth part of the cost of the enterprise besides incurring the grave risk of an entire failure of the enterprise itself. The subscription of the entire proposed amount of the capital stock is, therefore, a condition precedent to the legal existence of the company and the liability of the subscribers.[24] Some charters declare that, when a less amount than the whole capital stock is subscribed, a corporation may proceed to do business; but in the absence of such a provision, or of statutory modification, the common law rule, as stated, prevails. As said in an early Maine case, "The subscription having been made before the corporation was organized, was necessarily as well as in terms subject to a condition, that the party to accept it should have a legal existence, and should obtain the capital required by its charter and referred to in the subscription, by which it became a part of it."[25]

68. **Conditional subscriptions—Before organization.**—The courts are not agreed as to the effect of a subscription, necessary to the organization of a company, made conditionally prior to its formation. In general, it might be said that subscriptions essential to the formation of a corporation should be unconditional. The capital should be subscribed for

[24] Allman v. Havana, etc., R. Co., 88 Ill. 521. But see Schenectady, etc., Plank Road Co. v. Thatcher, 11 N. Y. 102.

[25] Oldtown, etc., R. Co. v. Veazie, 39 Me. 571. See also Bray v. Farwell, 81 N. Y. 600.

absolutely. A capital, which is subscribed for only conditionally, is little better than no capital at all. In New York, a line of cases holds that conditional subscriptions are wholly void. Thus, where a corporation was chartered to construct a plank road from X to Y, with the privilege of extending the road to Z if deemed desirable, and A subscribed for shares on condition that the road be built to Z, it was held that the corporation could not recover from A the amount of his subscription, Bowen, J., saying: "I think that the instrument signed by the defendant (A) is wholly void by reason of the condition therein contained."[26] The theory of this decision is that it is contrary to a sound public policy to have subscriptions to stock hampered and conditioned.

In Pennsylvania, on the other hand, the subscription is treated as binding and the condition regarded as void. In a leading case, the defendant subscribed upon the express condition that the eastern terminus of the proposed railroad should be located at or near H. It was held, "such subscription is to be regarded as absolute and unqualified, and any condition attached thereto is void."[27]

The court's reason was that "any other rule would lead to the procurement from the Commonwealth of valuable charters without any absolute capital for their support, and thus give rise to a system of speculation and fraud which would be intolerable."

[26] Fort Edward, etc., Plank Road Co. v. Payne, 15 N. Y. 583; Butternuts & Oxford Turnpike Co. v. North, 1 Hill 518 (N. Y.), LEADING ILLUSTRATIVE CASES.

[27] Caley v. Philadelphia R. Co., 80 Pa. St. 363; Boyd v. Peach Bottom R. Co., 90 Pa. St. 169.

69. **Same subject—After organization.**—A subscription upon condition precedent is one which requires the condition to be performed, unless waived, before the subscriber can become a member. If such a subscription is made *after* incorporation, two theories prevail as to its legal effect: (1) That the subscription is a mere withdrawable offer until the condition is fully performed. (2) That it is a binding contract from the time of making, to await the time of performance of the condition, and the subscriber cannot withdraw unless the corporation fails to perform. Such conditional subscriptions after incorporation must be carefully distinguished from those prior to incorporation. An already organized company may receive conditional subscriptions for its stock, and when it does so, it is bound to the performance of the conditions therein contained. It may dispose, after organization, of its stock, as of any other of its property, in such manner as, in its judgment, will best subserve the objects of its creation, and, to this end, may receive conditional subscriptions,[28] unless restrained by statute.

Subscriptions upon conditions *subsequent* are valid, and have the effect to make the subscriber a member from the time of acceptance by the corporation. If the corporation fails to perform the condition, the subscriber cannot withdraw, but has to rely upon his action for damages against the corporation for its failure to perform the condition. Courts will construe conditional subscriptions to be conditions

[28] Caley v. Philadelphia R. Co., 80 Pa. St. 363; Webb v. Baltimore R. Co., 77 Md. 92.

subsequent, if possible, rather than conditions precedent. There is a decided inclination to construe a proviso, if possible, as a condition subsequent and not a condition precedent and, therefore, binding.[29]

70. **Secret and fraudulent conditions.**—In a leading case, a subscriber to stock in a company to be formed agreed to take and pay for thirty shares "subject, however, to the condition, that if within one year he should elect to reduce the number so subscribed for to five, or any other number not less than five, he might be at liberty so to do." This latter agreement was embodied in a separate and distinct agreement from the contract of subscription. It was intended to be secret. The court held that while neither of the parties could complain, yet as against third parties, e. g., innocent subsequent subscribers, the collateral agreement could be adjudged fraudulent and void. "If they, for the purpose of misleading and deceiving third persons, having an interest in the subject of their contract, held out the subscription of the intestate as shown upon their subscription book, as the contract between them and him, and concealed from those third persons the fact, material for them to know, that there was a secret stipulation, making the contract an entirely different thing, the principles of common honesty would require that they should be compelled to stand to the agreement, as they held it out to be."[30]

Where parties for the purpose of deception, both sever and disconnect a conditional stipulation from

[29] Red Wing Hotel Co. v. Friedrich, 26 Minn. 112, 1 N. W. 827.
[30] White Mts. R. Co. v. Eastman, 34 N. H. 124.

the contract of subscription itself, so as to render it on its face an absolute engagement, whereas in reality it was something quite different, they are acting fraudulently, the familiar principle of equitable estoppel by conduct applies, and they have no legal standing to complain if the law holds the contract as between them to be what they held it out to be to others. That one man has bound himself to place a certain amount of his money upon the risk involved in the proposed corporate enterprise, is an inducement to others to venture their funds in like manner. To hold that a secret stipulation is valid would be, in law, a fraud upon other subscribers as well as upon the public dealing with the company. The party subscribing should be, and is, held bound to all the responsibilities of a bona fide subscriber.[31] Otherwise, there might purport ostensibly to have been taken a large amount of capital stock, whereas, in fact, there would be really no stock taken at all. The law, therefore, frowns upon all secret stipulations of any sort in subscription agreements, and treats them as a nullity.

71. **Payment of subscriptions.**—A subscription for stock implies a promise to pay for it, even though the subscription is before incorporation of the association. Of course, if there is an express promise to pay, no question can arise. Sometimes, however, there is no express promise. Then, as just seen, the weight of authority implies in law a promise to pay for the stock. In other words, an agreement to take stock

[31] Melvin v. Lamar Ins. Co., 80 Ill. 446. Compare Meyer v. Blair, 109 N. Y. 600, 17 N. E. 228.

implies an agreement to pay for it.[32] But in several New England states, including Maine, Massachusetts and New Hampshire, the law is otherwise and proof of an express promise to pay is requisite.[33] In the absence of such express promise, the only remedy of the corporation against the delinquent subscriber would be a forfeiture and sale of his stock. But the sounder view is that the act of becoming a stockholder is one from which the law may appropriately raise a promise to pay the installments due upon the stock as called for by the corporation; and the common law furnishes a remedy for a violation of this engagement by an action in assumpsit.

72. **Release and discharge.**—No power resides in the corporation, its officers or directors, to release a stockholder from payment of his stock subscription. In fact, this can be effected only upon the unanimous consent of the stockholders. Even then, the rights of creditors must be out of the way, for a release of a subscriber cannot be allowed to operate to the injury of a corporate creditor. As said by Judge Lurton in the well-known case of Cartwright v. Dickinson,[34] "The contract of shareholders is a mutual one. Without the consent of all one cannot be released from liability. Even a board of directors cannot discharge the contract of a shareholder to pay for his shares according to his contract, * * * ." A subscriber may, however, be released as part of a compromise entered into in good faith.

[32] Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336.
[33] Mechanics' Foundry & Mach. Co. v. Hall, 121 Mass. 272.
[34] 88 Tenn. 476, 12 S. W. 1030.

73. **Effect of change in corporate enterprises upon liability of subscribers.**—Suppose A agrees to take ten shares of stock in a corporation to be organized with a capital stock of $5,000. Suppose the corporation, as organized, has an authorized capital stock of $10,000. Is A liable on his subscription contract? Again, suppose A agrees to take ten shares of stock in a corporation to be organized to engage in the retail groceries business. Suppose the corporation, as organized, is to engage in the business of wholesale groceries as well. Is A liable? In both cases, the courts hold that there is no liability on A's part upon his stock subscription contract. The change in the nature and scope of the corporate enterprise operates to discharge him. A offered to take stock in a company with a capital stock of $5,000, not of $10,000. A offered to take stock in a company to engage in the retail business, not in the wholesale. In neither case is A liable. If, after one has signed a contract agreeing to form a corporation for a named purpose, such contract is changed in any substantial way, before the incorporation, without the subscriber's consent, he is not bound because the company formed is not the company he subscribed to.[35] It is the function of the trial court to construe the legal effect of the written instruments and to instruct the jury whether the provisions of the charter are substantially in accordance with the provisions of the subscription paper. Where they essentially differ as to location, amount of capital, object or scene of

[35] Norwich Lock Mfg. Co. v. Hockaday, 89 Va. 557, 16 S. E. 877, LEADING ILLUSTRATIVE CASES.

the enterprise, or the like, the subscriber is released for the company proposed to be formed and to whose stock he subscribed was never formed, and there was, accordingly, no acceptance whatever of his proposal to subscribe to stock in such a company. In general, the rule may be thus formulated: Any material departure from the original project as mapped out releases a subscriber.

74. **Same subject—Practically illustrated.**—In the following cases, the courts decided that the departure from the proposed scheme was so material as to operate to release the subscribers: (1) Where a project to construct one continuous railway across the State of Illinois was altered so as to divide it into three separate parts;[36] (2) Where the capital was fixed at $30,000 instead of $25,000;[37] (3) Where there was a substantial deviation from a proposed route of a railroad;[38] (4) Where the corporation proposed originally to preserve fruit by a patented process, but was actually formed to manufacture all preserved fruits and to can fruits and other products;[39] (5) Where the object of the proposed corporation was "dealing in automobiles and motor vehicles," and the corporation, as organized, was to engage in "the manufacturing, leasing, purchasing and selling of all kinds of automobiles, motor vehicles and other vehicles;[40] (6) Where there was the business of fire, marine and inland insurance superadded to the busi-

[36] Board v. Mississippi R. Co., 21 Ill. 337.
[37] Middlecoff Hotel Co. v. Yeomans, 89 Ill. App. 170.
[38] Champion v. Memphis & C. R. Co., 35 Miss. 692.
[39] Dorris v. Sweeney, 60 N. Y. 463.
[40] Woods Motor Vehicle Co. v. Brady, 181 N. Y. 145, 73 N. E. 674.

ness of life and accident insurance as originally proposed.[41]

On the other hand an immaterial change which is not a substantial departure from the project as originally outlined, will not serve to release a subscriber from liability. Thus, in Yonkers Gazette Co. v. Taylor,[42] a mere change in the corporate designation was regarded as of no legal effect or consequence.

75. **Effect of unauthorized acts of directors upon liability of subscribers.**—The mere mismanagement of the affairs of a corporation by its directors or managers has never been held to release subscribers from their obligations to the company. It constitutes, therefore, no defense to an action upon a stock subscription. The proper remedy of the stockholders is to resort to proceedings in equity to restrain the performance of the unauthorized acts, or to rescind and cancel them if already performed. But no cases hold that a stockholder is discharged because the directors have acted beyond their power or in its abuse.[43]

76. **Effect of change in corporate charter upon liability of subscribers.**—Whenever a power intervenes, over which the subscriber can have no control to alter in a material point the character of his contract without his assent actual or implied, such intervention works his release. Thus, where, by act of the legislature, a turnpike company was authorized to alter the termini of its road, it was held that a sub-

[41] Ashton v. Burbank, 2 Dill. C. C. 435 (U. S.).
[42] 30 App. Div. 334 (N. Y.), 51 N. Y. Supp. 969.
[43] Chetlain v. Republic Life Ins. Co., 86 Ill. 220.

scriber to its stock was released from his contract of subscription.[44] The reason is that such termini form a part of the conditions which enter into the making of the contract, and as the sovereign power, over which the subscriber has no control, intervenes to alter such conditions, he is thereby released. A contrary rule would involve the unreasonable supposition that a contract might be imposed upon a party who never assented thereto. In other words, the charter cannot be materially amended to bind a subscriber without his consent. Thus, in a Wisconsin case,[45] the legislature changed the enterprise from that of building a road to Beloit to one of building a road in a line entirely southwest of the original route and to a point only about half as far as Beloit. It was held to be such a departure from the original purpose that no member should be deemed to have authorized the corporation to assent to it for him. The power reserved in the state constitution to amend, alter or repeal corporate charters should not affect this result in any respect. Some cases seem to lay great stress upon the existence of this power and to intimate that, thereunder, the non-assenting subscriber to stock may be bound by a material change, whose effect would otherwise be to release him. But this power was never reserved upon any idea that the legislature could thereby alter a contract between a corporation and its stock subscribers. The legislature cannot force the corporation to accept the change. They grant it as a power to be accepted if the com-

[44] Indiana, etc., Turnpike Co. v. Phillips, 2 Pen. & Watts 184 (Pa.).
[45] Kenosha R. Co. v. Marsh, 17 Wis. 13.

pany so chooses. If the company accepts, whether the individual subscriber is bound or not, should logically be determined by the same principles precisely, as if the power of amendment had not been reserved.

In New York, however, the rule is different. In an early case,[46] it was held that a stockholder was not released from his subscription by the corporate acceptance of a subsequent legislative act enacted under the reserved power to amend, increasing the corporate capital and authorizing the construction of a branch road, though this was without the consent of the stockholder either express or implied. Judge Johnson said: "Every one who enters into such a company is aware of the reservation of the power of amendment and of the possibility of its exercise and trusts, as in many other matters he must trust, to the wisdom and justice of the legislature that this power will not be abused."

In another New York case,[47] the name of a railroad corporation was changed and an extension of its road was authorized. The court held that this did not operate to discharge a non-assenting stockholder from his obligation to the corporation, and that the power of alteration by the legislature was substantially unlimited.

77. **Fraud and mistake as affecting subscriptions.** —Fraud and mistake vitiate any subscription into which they enter, in the same way and to the same extent as in any other contract, and make it voidable

[46] Schenectady, etc., Plank Road Co. v. Thatcher, 11 N. Y. 102.
[47] Buffalo R. Co. v. Dudley, 14 N. Y. 336.

at the option of the subscriber. He must, however, be diligent in discovering the fraud or mistake, and prompt in repudiating the subscription after ascertaining the fact. The English, and some American cases, hold that even if the subscriber has acted with due diligence he cannot repudiate the subscription after insolvency of the corporation, and the rights of creditors have intervened;[48] other authorities hold that he can if he is not guilty of laches.[49]

In general it may be said with regard to subscriptions induced by fraud or misrepresentation that there is no question but that a subscriber may defend as against the corporation on those grounds. The important matter is whether he can defend where the rights of creditors might be hindered or impaired.

78. **Underwriting.**—An underwriting contract is a subscription contract whereby the underwriter agrees to take over at a certain price in return for a stipulated commission all of the shares of stock of the proposed corporation for which the public does not subscribe.[50] The underwriter is generally, but not at all necessarily, a large banking house in one of the metropolitan centers. These agreements are resorted to frequently in the floating of the gigantic industrial corporations which are so familiar a feature of modern business.

[48] Ashley's Case, L. R. 9 Eq. 263 (Eng.).
[49] Gress v. Knight, 135 Ga. 60, 68 S. E. 834; Fear v. Bartlett, 81 Md. 435.
[50] In re Licensed, etc., Trading Assn., L. R. 42 Ch. Div. 1 (Eng.).

CHAPTER VI.

THE CORPORATION AND THE STATE.

79. **State control of corporations in general.**—The state retains control over corporations, first through the courts, and second, through the legislature. The courts may, of course, exercise the same general control over corporations that they do over natural persons. The legislature, within certain limitations, may control its own creations. The subject of state control is one of great importance, especially in recent times. The growth of corporations has been so tremendous that it is highly important that they be suitably and adequately regulated. Today in this country there exist several hundred million dollar corporations; manifestly the only authority which can supervise and control these gigantic companies is the state itself.

80. **Visitation.**—The right of visitation existed in the old English corporations which were founded for charitable or similar purposes. The person who endowed the charity was given the privilege of visiting it in order to see that the terms of the foundation were being complied with. Sometimes instead of visiting the institution himself, the founder would appoint some one else to visit it for him. In the United States we find the direct descendant of this right of visitation in the appointment by the state of commissioners, whose duty it is to investigate the con-

ditions, especially in public service corporations. For example, in many states there exist today so-called public service commissions. These exercise a general supervision. Of recent years a tendency has decidedly manifested itself to extend this right of regulation to the purely private corporation. When we remember that, after all, the corporation is but the creature of the sovereign state which creates it, this tendency does not seem at all unreasonable. Besides, in no other way can the interest of the public be adequately safeguarded. The visitation of national banks by the Comptroller of the Currency and the bank inspectors is a striking example of the beneficial results of adequate regulations.

81. **Control by the courts.**—There are five methods available to the courts in endeavoring to control corporations: (1) quo warranto, (2) scire facias, (3) mandamus, (4) injunction, (5) indictment. The writ of quo warranto is used to bring a corporation into court in order to show by what authority it exercises its right to do business as a corporation. It is used in cases where a body of men are usurping the right to act as a corporation without authority. It is also sometimes used where the corporation is abusing the privileges and franchises conferred upon it. In this latter instance, quo warranto is used to show by what authority it exercises the powers which it is usurping or abusing. The action is ordinarily begun by the Attorney General, and the judgment is ordinarily one of corporate death, if the Attorney General is successful. In other words, the corporation is ousted from the state. The writ of scire facias

resembles quo warranto, and is also used where a corporation is abusing its authority. The writ of mandamus is a writ which a court may issue in order to compel the performance of a definite legal duty. For example, let us suppose that a corporation denies to the stockholder the privilege of inspection of its books, or that a public service company refuses to perform its duties. In such cases as these, the writ of mandamus will lie, in order to enforce the performance of the duty upon the corporation. The writ of injunction is obtained in a court of equity and may be employed in order to prevent the corporation from performing an unauthorized or illegal act. For example, suppose that a corporation organized to conduct a groceries business proposes to purchase and operate a theatre. This act is plainly in excess of its corporate powers. A writ of injunction could be obtained in order to prevent this from being carried out. Indictment is a criminal proceeding brought by the state and may be employed in order to punish a corporation for a public transgression, as shall be noted when the criminal liability of corporations is considered in subsequent sections. This remedy is employed frequently to-day and is an effective means of control.

82. **Control by the legislature.**—The legislature exercises control over corporations through the power of eminent domain, the police power and the taxing power. These are all powerful weapons in the hands of the legislature, and if properly employed prove of great value in the regulation of corporations. Besides these powers, the legislature under certain

circumstances may repeal, amend or alter corporate charters.

83. **Power of eminent domain.**—A natural person is liable at any time to have his or her property taken for the use of the state provided that due compensation be made; for example, the state wishes to build a bridge over a river and finds it necessary to condemn certain property in order to erect suitable approaches to the bridge. The property of the private individual may be condemned for this purpose under the power of eminent domain. The state often vests this valuable privilege in corporations where these corporations are engaged in public work, as, for example, a railroad company, a street railway company, a turnpike company, or the like. In return for this valuable privilege, the corporation may be subjected to a very considerable degree of state control.

84. **Police power.**—The police power is sometimes referred to as the Dark Continent of American Jurisprudence. This is because its limitations are so vague and indefinite. The police power is incident to sovereignty. In a general way it might be said that under the police power the sovereign state has the right to control public health, public morals, public safety, and in general, all matters relating to public welfare. Suppose a corporation has been chartered for the express purpose of carrying on a lottery or of selling liquor, and that subsequently the state has forbidden the conduct of the lottery or the sale of liquor. Under the police power, the state may forbid the corporation from continuing to carry on the lottery or the

sale of liquor because these are matters relating to the public morals and welfare and may legitimately be regulated and controlled under the police power. Corporations are subject to the exercise of the police power in the same way and to the same extent as private individuals. Under the police power, insurance or banking corporations may very properly be required to present annual reports for the guidance of the public. Likewise, the rates charged by public service companies may be regulated. As the corporations increase in size and number and as the necessity for state control grows more and more apparent daily, it is quite clear that in the police power the state must ultimately seek the solution of the problem of adequate regulation. The very fact that the limitations of the police power are so ill defined furnishes one of the strongest reasons why in the police power the state may find its most valuable weapon.

85. **Taxing power.**—The state has the same right to tax corporations that it has to tax private individuals. The chief elements of corporate taxation are (1) the franchise, (2) the corporate property, real or personal, tangible or intangible, (3) the capital stock of the corporation, (4) the earnings, gross or net, (5) the shares of stock of the corporation owned by its shareholders. Strange as it may seem, all of these may be taxed although this might even result in double or even treble taxation in some cases. The value of the taxing power as a means of state control is very great. Under a properly graduated tax, a solution of the problem of corporate trusts and monopolies might very possibly be found.

86. **Same subject—Franchise tax.**—A corporation possesses two franchises, its primary franchise and its secondary franchises. Its primary franchise is its right to exist and to do business as a corporation. This franchise really belongs to the shareholders and is their property rather than that of the corporation. It enables them to do business as a legal unit and might be defined as the right to be and act as an artificial body.[51] The secondary franchises of the corporation are special privileges which are conferred upon it by legislative grant, as, for example, the power vested in a street railway corporation to occupy the public streets. Both the primary and secondary franchises of a corporation may properly be taxed. Sometimes they are of small value, but oftentimes they are extremely valuable. In all cases, the value of a franchise is very difficult to estimate. The best working test would seem to be the business expert's estimate of its value. Corporate franchises granted by the national government are not taxable by the states unless Congress gives its consent.

87. **Same subject—Tax on property.**—Just as the property of a private individual may be taxed, so the state may tax the property of a corporation. Its real estate, its personal property, its intangible assets,—all of these are subject to taxation. Of recent times there seems to be a tendency to taxing the property of a corporation as a unit and have all of it assessed by one general state board instead of local assessors.

[51] Fietsam v. Hay, 122 Ill. 293, 13 N. E. 501, LEADING ILLUSTRATIVE CASES.

88. **Same subject—Tax on capital stock and shares of stock.**—The capital stock of a corporation is the fund dedicated by the associates to the corporation enterprise. It is owned and held by the company in its corporate capacity. The shares of stock represent the interest of the associates in the corporate enterprise. The courts hold that shares of stock are taxable, although the capital stock is also taxed.[52] At first sight, this would seem to be double taxation on the same property. The courts hold, however, that the taxation of the capital stock of the corporation and also of the shares of stock bears no resemblance to taxing the same tract of land twice to the same person. The corporation, after all, is a person distinct and separate from the shareholders. Its stockholders are wholly separate and apart from it, and the courts say that the capital stock of the corporation may, therefore, be taxed and also the shares of stock in the hands of the individual stockholders. The distinction between capital stock and shares of stock for purposes of taxation is well illustrated in the leading case of Van Allen v. Assessors.[53] In that case it was held by the Supreme Court of the United States that shares of stock of national banks are subject to state taxation, even though their entire capital stock is invested in United States bonds, declared by Congress to be "exempt from taxation by or under state authority." In other words, the capital stock of the corporation was shielded, but the shares of stock of the shareholders were taxed.

[52] Cook v. City of Burlington, 59 Iowa 251, LEADING ILLUSTRATIVE CASES.
[53] 3 Wall. 573 (U. S.).

89. **Power of repeal and forfeiture.**—Where the state legislature in creating a corporation has reserved the right to repeal its charter, it may do so at any time and without giving any reason. This power is very rarely exercised, and ordinarily corporate charters are repealed only in cases of gross abuse. The state legislature, as a general thing, does not intervene, but leaves the question of forfeiture to the courts to decide after a proper judicial determination of the facts of the case. However, where the power of repeal is reserved by the state, there can be no question but that the right may be exercised, subject only to the restriction that vested property rights be not destroyed.

90. **The corporate charter as a contract.**—Suppose X, Y, and Z apply to the sovereign state for a charter to do business as a corporation to manufacture clothing, and suppose that the charter is granted to them. The courts hold that in this transaction there are found all the elements of a contract. In other words, a charter is a contract, and being such, it can be amended, or altered, or repealed only by the consent of both parties; that is, the state on the one hand and the corporation on the other. The reason for this is found in the constitutional provision that no state may pass any law or enactment interfering with the obligations of a contract. In England, of course, the situation is different, because Parliament is supreme and may pass any law which it pleases. In this country, however, the legislatures are restricted by constitutional provisions. One of these provisions, as we have just seen, is that a state may not interfere

with the obligations of a contract, and as a corporate charter is interpreted as a contract, it necessarily follows that the corporate charter cannot be interfered with unless the corporation consents.

91. **Dartmouth College v. Woodward.**—One of the most famous decisions of the Supreme Court of the United States is that rendered in the case of Trustees of Dartmouth College v. Woodward.[54] In 1769 the King of England granted a charter to twelve persons, incorporating them under the name of "The Trustees of Dartmouth College." They were granted the usual corporate privileges and powers, and were authorized to govern the college and to fill up all vacancies which might be created in their own body. In 1816 the legislature of New Hampshire passed an act making numerous alterations in the corporate charter, increasing the number of trustees to twenty-one, and also creating a board of overseers with power to inspect and control the most important acts of the trustees. The trustees of Dartmouth College refused to accept the amended charter, and brought suit to recover the corporate seal, books, and records, which were in the possession of one Woodward, who held them by virtue of the acts of the New Hampshire legislature above stated. A bitter controversy ensued, and the trustees relied upon the provision in the Federal Constitution declaring that "no state shall pass any law impairing the obligation of contracts." The college called upon its most distinguished graduate, Daniel Webster, to argue the case on its behalf before the Supreme Court of the United States. After

[54] 4 Wheat. 518 (U. S.), LEADING ILLUSTRATIVE CASES.

lengthy deliberation, the Supreme Court held that the legislative acts of the state of New Hampshire, under which the defendant held the property, impaired the obligations of the charter, and were therefore unconstitutional under Article 1, § 10 of the Federal Constitution, above cited. The main opinion was written by Chief Justice Marshall. He said: "It can require no argument to prove that the circumstances of this case constitute a contract. An application is made to the Crown for a charter to incorporate a religious and literary institution. In the application it is stated that large contributions have been made for the object, which will be conferred on the corporation as soon as it shall be created. The charter is granted, and on its faith the property is conveyed. Surely, in this transaction every ingredient of a complete and legitimate contract is to be found." To the objection that no consideration existed, Justice Story made the following answer in his opinion: "For this purpose it matters not how trifling the consideration may be; a peppercorn is as good as a thousand dollars."

From this decision in Dartmouth College v. Woodward, there has arisen a great mass of corporation law. If a charter of a corporation is a contract, it stands to reason that the state cannot alter the charter after granting it. This is a very serious proposition, as anyone may readily see. It means that the state after granting a charter cannot alter it or change it in any respect unless the corporation consents. In other words, the state is left practically helpless as against the monster which it has created.

The decision in Dartmouth College v. Woodward, with all deference to the Supreme Court, was an unfortunate one. A corporate charter is no more a contract than is any other franchise. A corporate charter is simply a privilege accorded by the sovereign state to a group of individuals authorizing and enabling them to transact business as a legal unit. It is a franchise, a grant, from the state, and in no true sense of the word a "contract."

92. **Same subject—Effect of the decision.**—The effect of the decision in the Dartmouth College case was of course very grave. The states had to devise some method of control over corporations. They hit upon the scheme of inserting in corporate charters thereafter granted the right to repeal, alter, or amend them at the pleasure of the state. In other words, the states reserved, in the original contract, the right to alter it. Under this reserved power, the states today exercise control over corporations, but if this power is not reserved the state is helpless. For example, if the state has not reserved to the legislature the right to repeal or grant the corporate charter, in the original grant, it cannot do so thereafter.

93. **Power to amend and alter.**—The state today ordinarily reserves the right to amend or alter the corporate charter when it grants the corporate franchise. The reservation of the right to alter, amend, or repeal the act by which the corporation is created does not mean that the legislature can force the amendment or modification upon the corporation without its consent. It simply means that if the corporation does not accept the modification or amend-

ment, it must discontinue its operations as a corporate body in the state. As held by the Court of Appeals of Virginia, "Every amendment or modification of a charter of incorporation is nothing more than a *new contract,* which is not binding upon the corporate body until accepted by them."[55]

Under the reserved power to amend, it must be remembered that the state can only offer an amendment. It cannot require something entirely new or distinct to be done; for example, it cannot require a wholesale groceries company to build and operate a street railway. This subject, however, is properly one of constitutional law rather than of private corporations.

94. **Assignability of franchise.**—The question has frequently arisen whether a corporate franchise is assignable. The question has almost uniformly been answered in the negative. As held by Judge Matthews in Memphis Railroad Company v. Railroad Commissioners,[56] "The franchise of becoming and being a corporation, in its nature, is incommunicatable by the act of the parties and incapable of passing by assignment." The franchise of being a corporation belongs to the corporators, and therefore the corporation has no power to dispose of it. In a leading case,[57] a bank became insolvent and made a general assignment of all its property for the benefit of creditors. The assignee presented a petition for

[55] Yeaton v. Bank of the Old Dominion, 21 Grattan 593 (Va.), LEADING ILLUSTRATIVE CASES.

[56] 112 U. S. 609, 28 L. Ed. 837.

[57] Fietsam v. Hay, 122 Ill. 293, 13 N. E. 501, LEADING ILLUSTRATIVE CASES.

leave to sell the corporate franchise. The question was whether the title to the franchise created by the bank charter passed as an asset of the bank to the assignee under the assignment. The Supreme Court of Illinois held unanimously that the corporate franchise was incapable of being assigned or transferred by the corporation. Since the franchise is vested in and belongs to the corporators and not to the incorporation, it follows that the corporation cannot transfer or assign it. This is the general rule throughout the United States, although in a few jurisdictions, as the result of statute, the rule is otherwise.

95. **Corporate trusts and monopolies.**—As early as the time of Queen Elizabeth, the courts were worried with the question of monopoly. A corporation enables many people to pool their capital and act together as a unit. This is an advantage in so far as it enables people to combine their capital in order to carry on a large enterprise. The factor of individual greed steps in, however, and it can readily be seen how the corporation, instead of being an instrument for good, may also become a source of grave injustice and oppression. Suppose, for example, a corporation obtains control of a necessary of life to such an extent that it can dictate the price at which that commodity can be sold. This is manifestly undesirable, and should be prevented. There are two ways of dealing with the problem. In the first place, the corporation might be dissolved. In the second place, the corporation might be regulated.

No statute is necessary in order to decree corporate dissolution where the corporation has obtained such

unfair control as to amount to an unreasonable restraint upon trade and competition. There is no need for a statute. The common law forbids all unfair and unreasonable interference with trade and commerce. Therefore, apart from statute, there can be no question but what the courts have the power adequately to regulate the subject of corporate trusts and monopolies. This was done as early as the days of Queen Elizabeth, and there exists no sound reason why it cannot be done in the United States today.

With regard to the regulation of gigantic corporations, instead of their dissolution, there is this to be said: that, under proper supervision, the advantages of combination may be retained while the disadvantages are eliminated. Congress has regulated railroads by means of the Interstate Commerce Commission. Many people argue that it can also regulate the great interstate industrial corporations by means of an interstate corporation commission. The difficulty is, as in all cases of regulation, to obtain a suitable and competent commission. An incompetent commission could cause more evils than today exist. There is no question, however, of the right to appoint such a commission. It would simply be an extension of the old common-law right of visitation.

96. **Same subject—The Standard Oil and Tobacco Trust decisions.**—The Congress of the United States has endeavored to deal with the question of corporate trusts and monopolies by the enactment of a statute which is generally known as the Sherman Anti-Trust Act. This statute forbids all restraints on trade and competition. It was originally believed this meant

that any and all restraints on trade were illegal, without regard to whether they were reasonable or unreasonable, beneficial or injurious. It was insisted that both "good" trusts and "bad" trusts were forbidden, and that, without regard to the extent of the restraint, all interferences with free competition were forbidden; and, it may be said, several decisions of the Supreme Court of the United States apparently adopted this view. Keen students of the law of corporations, however, were not surprised when the Supreme Court recently decided in the case of the Standard Oil and Tobacco Trusts that only unreasonable restraints on trade were forbidden. In Standard Oil Company v. United States,[58] the "rule of reason" was adopted. The Standard Oil Corporation of New Jersey was held to be acting unfairly and improperly in restraint of trade, and was ordered dissolved. The court went further, however, and declared that only unreasonable and unfair restraints were illegal. In a sense, it might be said that this was unnecessary to the decision and therefore mere dictum. However, the court was emphatic upon the proposition, and a short while later, in the Tobacco Trust decision, again used similar language. The interpretation placed upon the Sherman Anti-Trust Act by the Supreme Court of the United States is thus in accordance with the rule of the common law, and furnishes a shining example of the ability of the common law, working down from precedent to precedent, to deal with all situations that might arise. In some jurisdictions, notably New Jersey, the statutes

[58] 221 U. S. 1.

attempt to define in detail what is and what is not monopoly. As a general thing, these statutes are simply declaratory of the common-law rules. Where they are not declaratory, they usually serve only to cause further uncertainty and confusion. The courts may safely be entrusted with the regulation of the corporate trust and monopoly, and they will solve it just as successfully as they have solved the thousands of other great problems which have confronted the English-speaking people ever since the days of Magna Charta.

CHAPTER VII.

CORPORATE POWERS.

97. **Theories of corporate capacity.**—There are two general views of corporate capacity. The first of these is, that a corporation possesses general capacity, by which is meant that the corporation, once it has been created, may do anything that a natural person can do. In other words, that a corporation may do any act at all which is not illegal, without exceeding its powers and capacity. This view concedes that a corporation has no right to exceed the limits of its charter, but admits that it has the power to do so. The theory of special corporate capacity is that which is almost universally adopted in the United States. It declares that a corporation possesses only the powers which are expressly conferred upon it in the corporate charter, and those which are reasonably incidental to the powers that are expressly conferred. In other words, the view is taken that since the corporation is but the creature of the state, it possesses only those powers with which the state has vested it, or those which result inevitably therefrom,—all other powers being absolutely excluded. The English courts and English legal authors apparently favor the doctrine of general corporate capacity, but the American decisions are practically unanimous in their support of the other theory.[59] At the same time, in the case

[59] Thomas v. Railroad Company, 101 U. S. 71.

of the ordinary private corporation, the courts in this country take a very liberal view of its powers. The reason is that if the sovereign state does not intervene, there seems no good reason for confining the operations of the corporation too closely.

98. **Construction of charters.**—The language of a charter should be construed so as to carry out, if possible, the legislative intention. The primary principle of interpretation of all written instruments is to seek to ascertain the intention of the parties, and corporate charters are no exception to this rule. The language of the charter should not be liberally construed on the one hand, nor construed too narrowly on the other. As said by Vice-Chancellor Bacon: "I wholly repudiate the notion that I am at liberty to adopt what has sometimes been called a liberal construction. I have no more right to do that on the one hand than I am at liberty on the other to adopt a more rigorous or more strict construction than the express stipulations of the instruments require. What the law requires and what I am called upon to do is to put a just construction, and no other, upon these instruments."[60] Wherever words are ambiguous, they are to be given their ordinary construction. Another important principle is that where the question arises between the state and the corporation, the construction most favorable to the interests of the state should be adopted. In other words, under these circumstances, the rule of strict construction as against the corporate powers should be applied. For example, where a corporation is given the right to

[60] London Financial Association v. Kelk, 26 Chan. Div. 107, 134 (Eng.).

construct a subway in a municipality, this does not mean that the corporation has the exclusive right to build and operate subways. Another corporation could be authorized to do this, even though serious injury to the business of the first company might ensue.

99. **Powers in general.**—The determination of the powers of a corporation is by no means a simple matter. In fact, a great deal of corporate litigation arises out of dispute as to whether a corporation possesses or does not possess a certain given power. Let us suppose that corporation X claims that it has the right to purchase the stock of corporation Y. A minority stockholder in corporation X objects, and insists that the purchase of stock in corporation Y is an improper and unauthorized use of the funds which he has dedicated to the corporate enterprise. Let us further suppose that the corporate charter and the local statutes are silent on this topic. It can readily be seen how difficult is the determination of the question. In general, it might be said that the determination of the powers of a corporation involves a mixed question of law and fact; that is, a question of fact to be determined by the trial court pursuant to certain general rules, above indicated, of interpretation and construction. In the first place, the courts should consider the character of the corporation itself, and its object and purpose. Very clearly the implied powers of a banking corporation might differ very materially from those of an ordinary trading corporation, and the powers of the latter, in turn, might differ very greatly from those of a public-

service company, such as a railroad. The following classification is convenient: Corporations may be divided into four classes in order to determine their implied powers: (1) the ordinary private corporation for pecuniary profit, such as a manufacturing or trading company; (2) the so-called moneyed corporation, such as a bank, a trust company, or an insurance company; (3) quasi-public corporations, or public-service companies, as they are sometimes called, such as street railway companies, water companies, telegraph companies, gas, electric light and power companies, and other corporations which are under a duty to serve all without discrimination and at a reasonable rate; (4) eleemosynary corporations, such as hospitals, churches, and the like; in this latter classification there might also properly be placed educational corporations, such as private colleges, schools, and universities. This classification will be found very serviceable. A banking corporation, for example, occupies a very different relation to the public than does a wholesale grocery company. The courts recognize this distinction in determining questions of corporate powers. In the second place, the court should consider the means and methods which are employed at the particular period, according to approved usage or custom, to accomplish the corporate object or purposes. For example, a corporation ordinarily has no power to obligate itself as a surety or guarantor. However, the custom of the community, approved by reputable business men, may warrant this. In determining, then, whether the corporation can act as surety, the court could not decide

the question along merely academic lines, but would have to consider what is sanctioned by approved business usage at the time in question, in the community in question, with regard to corporations of the kind in question. The question, of course, is very largely a question of evidence. In a famous recent English case, Lord Justice Buckley said: "To ascertain whether any particular act is ultra vires (beyond the powers) of the corporation or not, the main purpose must first be ascertained; then the special powers for effectuating that purpose must be looked for, and then, if the act is not within either the main purpose as described in or the special powers expressly given by the statute, the inquiry remains whether the act is incidental to or consequential upon the main purpose and is a thing reasonably to be done for effectuating it."[61] This is a good working test, but, as might be expected its application is oftentimes extremely difficult.

100. **Same subject—Illustrations.**—Suppose a corporation is established to carry on the hotel business and express power is given to buy land at a particular place and to build a hotel, and that, beyond this, the articles of association are silent. What can the hotel corporation do? What are its implied powers? It could certainly purchase furniture, linens, and provisions. It could hire servants. Could it run an omnibus line? If the carriages were used for the convenience of guests, this would be intra vires, which means, within the corporate powers. On the

[61] Attorney-General v. Mersey Ry. Co., L. R. (1907) 1 Ch. Div. 81, L. R. (1907) A. C. 415 (Eng.).

other hand, if the ownership and running of omnibuses were a distinct business, unrelated to the hotel business, and not merely incidental thereto, then clearly the maintenance and working thereof would be unauthorized. Could the hotel maintain golf links? Yes, undoubtedly, if it were located in the country. Golf links in the country might be quite as necessary as an elaborate tea-room in a city hotel. What is intra vires for a hotel located in a popular summer resort might be absolutely ultra vires for the La Salle Hotel in Chicago or the Astor Hotel in New York. Could the hotel acquire rights of fishing and supply boats and launches? Again, the question is one of fact, or rather, of mixed law and fact. The question is, in each case: Is the particular act in question an act which, under the circumstances of the particular case, is incidental to or consequential upon or reasonably necessary for effectuating the main purpose for which the corporation is organized. In this connection it should be borne in mind that "necessary" does not mean indispensable, but merely that which is reasonably convenient and usual in order to carry out the corporate purpose.

In a leading federal case,[62] a railroad company leased and operated a hotel in Florida. This was for the accommodation and use of its passengers, as the hotel was located at a terminus of the railroad situated at a beach, far distant from any town. In deciding the case, Justice Shiras said: "To maintain cheap hotels or eating-houses at stated points on a long line of railroads through a wilderness, as in the

[62] Jacksonville, etc., Ry. & Nav. Co. v. Hooper, 160 U. S. 514, 40 L. Ed. 515.

case of the Pacific railroads, or at the end of a railroad, on a barren, unsettled beach, as in the present case, not for the purpose of making money out of such business, but to furnish reasonable and necessary accommodation to its passengers and employees, would not be so plainly an act outside the powers of a railroad company as to compel a court to sustain the defense of ultra vires, as against the other party to such a contract."

In an early Massachusetts case,[63] a contract made by a ferry company to lease one of its boats was alleged to be void because not in the legitimate exercise of the corporate powers. This contention was overruled, and Chief Justice Bigelow said: "Undoubtedly the main business of a corporation is to be confined to that class of operations which properly appertain to the general purposes for which its charter was granted. But it may also enter into and engage in transactions which are incidental or auxiliary to its main business, which may become necessary, expedient, or profitable in the care and management of the property which it is authorized to hold under the act by which it was created."

In a recent Pennsylvania case,[64] the court held that a corporation organized for the object of supplying illuminating and heating gas might not only deal in the gas itself but could also deal in such contrivances and patented conveniences as would induce people to use more gas than they otherwise perhaps would. On the other hand, the New York Court of

[63] Brown v. Winnisimmet Co., 11 Allen 326 (Mass.).
[64] Malone v. Lancaster Gas Co., 182 Pa. St. 309, 37 Atl. 932.

Appeals has held that a corporation organized to manufacture and sell gold and silver ware is not authorized to purchase gold and silver ware from other manufacturers and sell same to its customers. This adopts a rather narrow view, but in support of it, Chief Justice Andrews said: "The unexpressed and incidental powers possessed by a corporation are not limited to such as are absolutely or indispensably necessary to enable it to exercise the powers specifically granted. Whatever incidental powers are reasonably necessary to enable it to perform its corporate functions are implied from the powers affirmatively granted. But powers merely convenient or useful are not implied if they are not essential, having in view the nature and object of the incorporation."[65] The courts, of course, are rarely in complete accord on these questions of corporate power. Much of the difficulty apparently arises from the unfortunate use of the term "power." In the last analysis, a corporation has power to do anything. The question is, not so much whether it has the power to do the act as it is whether the corporation has the right to do the act. To illustrate: A and B enter into a contract; A has the power to break it, but that does not give to A the right to break it. In the same way, suppose a corporation is organized to purchase and sell retail groceries. It has the power, but surely not the right, to purchase and operate a circus and menagerie. Yet we speak, rather illogically, of the want of corporate power to purchase the circus and menagerie. The terminology is misleading and confusing.

[65] People v. Campbell, 144 N. Y. 166, 38 N. E. 990.

101. **Power to contract.**—At common law, all corporate contracts had to be made under seal. Under the American doctrine, however, a corporation may make contracts without the use of a seal. The doctrine that no corporate act can be binding unless it is under the corporate seal has long ceased to be maintained. Today, even in England, a corporation can be held liable on an implied contract and, of course, such contracts are not under seal. Corporate contracts should be made in the corporate name; likewise, conveyances of land should be to the corporation in its corporate name and capacity. Similarly, the conveyances of the corporation should be granted and executed by it in its corporate name. The validity of corporate contracts may be determined by applying four tests: (1) Was the corporation authorized to enter into the contract? (2) Was it made on behalf of the corporation by an authorized corporate agent or officer? (3) Were the proper formalities observed in its execution—that is, was it made in proper form and pursuant to the corporate charter and by-laws? (4) Is the contract itself legal—that is, is it in accord with public policy? To illustrate each of these: (1) If a corporation chartered to construct and operate a theater contracts to purchase five thousand yards of silk, the contract is obviously ultra vires, since a theatrical corporation is not in the dry goods business. (2) Suppose a brakeman on the Pennsylvania Railroad enters into a contract on its behalf to purchase one hundred tons of steel rails. The brakeman clearly has no authority to bind the corporation in this manner. He is not

authorized to make such contracts on the corporate behalf. If the president and general manager of the railroad had made the contract, the case would be very different. The test is, whether the act done was within the actual or apparent scope of the authority vested in the corporate officer or agent. (3) Suppose that the statutory provisions require that corporate contracts be signed both by the president and secretary of the corporation. These provisions must be observed. If they are not, the contract is not made pursuant to the statutes. Suppose that corporate contracts must be made under seal. A contract not under seal is void. (4) The usual rules of illegality and of public policy apply to the contracts of corporations just as they do to those of individuals. For example, suppose a corporation employs X to go to the national legislature and lobby on behalf of the corporation in order to prevent the tariff on sugar being lowered by Congress. This contract is invalid, because against sound public policy. Suppose corporation X and corporation Y agree not to sell their product below a certain fixed rate. This contract is invalid, because it tends toward monopoly and imposes an unfair restraint upon freedom of competition. In other words, the usual and ordinary rules of legality and illegality of contracts apply to the agreements of corporations just the same as they apply to those of private individuals.

102. **Power to borrow money and issue negotiable paper.**—A corporation may borrow money if this is necessary and appropriate for the transaction of the corporate business. It may contract debts for its

legitimate corporate objects to any extent that its credit will allow, unless forbidden by statute. Sometimes state statutes limit the amount of money which a corporation may borrow. It is held, however, that a person who lends money in good faith to a corporation may recover the amount even though the corporation had already borrowed beyond the authorized limit. This holds true only where the lender acts in good faith and has no actual knowledge of the circumstances. In a few jurisdictions, the lender cannot recover even though his loan was made innocently and without knowledge. Similarly, the courts hold that a corporation may issue promissory notes. If it can contract debts, it can also make provision for their payment, by drawing, endorsing, or accepting notes or bills of exchange.[66] In a few early cases, the courts apparently took the view that only trading corporations could issue promissory notes. However, in later cases it has been held that any corporation, including railway companies, may issue any form of negotiable instruments. If a corporation has power to give a promissory note for any purpose, a holder for value in good faith, without knowledge of any irregularity, will be protected.

103. **Power to make or endorse accommodation paper.**—At common law a corporation has, in general, no implied power to execute or endorse promissory notes for accommodation. The reason for this is obvious. The corporation is not in business to do favors as an accommodation to third parties. How-

[66] Bradbury v. Boston Canoe Club, 153 Mass. 77, 26 N. E. 132, LEADING ILLUSTRATIVE CASES.

ever, if a corporation has authority to issue promissory notes, a bona fide purchaser without knowledge of the fact that the instrument was given by way of accommodation will be protected. The rule seems well settled that the promissory note of a corporation for accommodation is enforcible in the hands of a holder in due course.[67]

Where all the shareholders consent, it has been held that this validates the accommodation paper. The theory is that if all the stockholders assent and the corporate creditors are not injured, there is no reason of public policy for interference. The theory of a corporation is that it has no powers except those expressly given or necessarily implied. As has been seen, this rule is not strictly applied to ordinary corporations for pecuniary profit; and a private corporation of this type may exercise numerous extraordinary powers, provided the shareholders are willing. There is no one to complain except the state, and, the business being entirely private, the state does not interfere.[68]

104. **Power to acquire and convey property.**—A corporation, at common law, may acquire as much personal property, both as to amount and kind, as it deems necessary for its corporate purposes. Roughly speaking, there is no limitation to the amount of personal property which a corporation may acquire. At common law, it was generally held that a corporation

[67] Monument National Bank v. Globe Works, 101 Mass. 57, LEADING ILLUSTRATIVE CASES.

[68] Murphy v. Arkansas & L. Land & Improvement Co., 97 Fed. 723, LEADING ILLUSTRATIVE CASES; Martin v. Niagara Falls Paper Mfg. Co., 122 N. Y. 165, 25 N. E. 303.

also had the right to acquire as much real property as it deemed necessary. In fact, the Supreme Court of the United States has said: "At the common law, every corporation has, as incident to its existence, the power to acquire, hold, and to convey real estate, except so far as it was restrained by its charter or by act of Parliament. This comprehensive capacity included also personal effects of every kind."[69] This rule, however, has been very considerably modified in the United States, and in most jurisdictions corporations are regarded as having the right to purchase and hold only that amount of real property which is strictly necessary for the corporate purpose. The reason for this is to prevent too much of the land in a state to be tied up in the hands of corporations. The activity and the schemes of a private individual —that is to say, a human being—are limited by the short span of human life; whereas a corporation, in the absence of statutes, may exist forever. Theoretically, at least, there is no limit whatever to the plans of a corporation. For this reason, in such jurisdictions as Illinois, for example, corporations cannot be formed to deal in real estate; and the amount of real property which an ordinary corporation may hold is strictly limited to that quantity which is absolutely essential in order to carry on the corporate business. Thus, a bank could purchase a plot of land in order to erect a building within which to carry on its banking business. It could not, however, purchase five hundred acres of farm land as an agricultural speculation.

[69] Jones v. Guaranty Co., 101 U. S. 622, 25 L. Ed. 1030.

Likewise, a corporation has the right to sell or convey its property. A railway corporation, or other public-service company, however, is forbidden to alienate such of its property as is required by it in order properly to perform its duties to the public. The reason for this is that public or quasi-public corporations owe duties to the general public as well as to their shareholders and cannot disable themselves from the performance of their obligations. Thus, where a railway company leased its road, its rolling stock, and franchises, this was held to be an invalid transaction. Where, however, the property is not essential to its operation and service, the public-service company may dispose of its property. In the case of the ordinary private corporation, however, these restrictions, in the absence of statute, do not apply.

At an early day, it was contended that a corporation whose term of existence was limited could not take and hold a fee simple in real estate. This idea, however, never obtained much foothold. The life of every human being, even that of a Methuselah, is limited. Yet a human being can take and hold a fee simple, that is, an estate in land to himself and his heirs forever. Why, therefore, cannot a corporation also hold a fee simple? In Nicoll v. New York R. Co.,[70] it was held that a corporation, with a limited term of existence, might hold a fee simple. In the same way it has been held that a corporation may hold a franchise existing beyond its own life. On the termination of the corporation, the franchise is a

[70] 12 N. Y. 121.

divisible asset for the benefit of the creditors and the shareholders of the corporation.[71]

105. **Power to alienate all its property.**—The question of whether a corporation may alienate all its property is much disputed. It is certain that a corporation which is making money and is a solvent, going concern has no power to transfer all its property, thus bringing about a practical dissolution, unless all its shareholders consent. The reason for this is that the shareholders have the right to insist that the corporate enterprise, if successful, be continued. In a leading Illinois case, the supreme court of that state decided that where a corporation is "a solvent and going concern, and doing and able to continue to do a profitable business," the sale to another corporation of the entire property and assets of the first corporation could be prevented by the protest of a single dissenting stockholder. The remedy of the stockholder is to go to equity and obtain an injunction to prevent the sale. If the sale has already been consummated, his remedy is to seek a rescission and accounting.[72]

On the other hand, where a corporation is losing money and is in failing circumstances, it may by a majority vote of its stockholders alienate all its property and assets in order to wind up its business and prevent further loss. "If this be not so, we do not see that any limit could be put to the business of a trading corporation, short of the entire loss or destruction of its corporate property. The stockholders

[71] Minneapolis v. Minneapolis St. R. Co., 215 U. S. 417, 54 L. Ed. 259.
[72] Harding v. American Glucose Co., 182 Ill. 551, 55 N. E. 577.

could be compelled to carry it on until it came to actual insolvency. Such a doctrine is without any support in reason or authority."[73] If the majority of the stockholders decide arbitrarily, and without good reason, to sell out the entire property of the corporation, and thereby compel the winding up of its business, this is a fraud, in the eyes of the law, upon the minority. And equity will interfere. However, if just cause exists for selling out the property, as when the business is a failure, and the best interests of everybody require this, it is within the power of the majority to order the sale, and the corporate act in so doing is intra vires. It would be a harsh rule that would allow a few stockholders to hold the others to their investment where a business man with good common sense would immediately say that the corporate business should be sold out.

106. **Power to pledge or mortgage.**—A corporation has the right to pledge or mortgage its property, provided that this is necessary and appropriate for the carrying on of its business.[74] Likewise, it may mortgage its property in order to secure future advances. However, a railway or other public-service company is not allowed to pledge or mortgage its property in so far as the property is requisite for the performance of its public functions. The reason is that every pledge or mortgage may result in the loss of title, and disable the corporation from performing the duties imposed upon it and which it

[73] Treadwell v. Salisbury Mfg. Co., 7 Gray 393 (Mass.); Rogers v. Pell, 154 N. Y. 518, 49 N. E. 75.

[74] Aurora Agl. & Hort. Society v. Paddock, 80 Ill. 263.

undertook faithfully to carry out. In many jurisdictions, today, railway companies, and other quasi-public corporations as well, have been given by statute the power to mortgage their property. This is generally accompanied, however, by strict safeguards.

107. **Power to lend money or credit.**—As a general proposition, private corporations possess no implied power to lend their money or credit. That is, they cannot lend cash on the one hand, nor act as a surety or guarantor on the other. This rule, however, is not absolute. In Illinois, it has been held that a brewery company has implied power to lend cash to a saloon-keeper for the purpose of erecting a saloon and public hall where its beer would be sold.[75] On the other hand, it seems clear that the brewery company would be unauthorized to lend money to a department store. In the last analysis, it would seem that a corporation might lend money where this is strictly necessary and appropriate to the corporate enterprise. Business usage and custom in the locality would play a very considerable part. In general, the power would not be readily implied. It was held in a New York case that a manufacturing company could lend cash to another corporation in order to enable it to furnish certain goods which it had ordered.

Where the corporate business makes it imperative for the corporation to obligate itself as a surety or guarantor, it may perhaps do so, provided it does so strictly for its own benefit and provided there flows to the corporation a valuable consideration. Thus,

[75] Kraft v. West Side Brewery Co., 219 Ill. 205, 76 N. E. 372.

in a Wisconsin case, a guarantee by a brewing company of the payment of rent for a hotel company selling its beer, was upheld.[76] On the other hand, a corporation is not authorized to sign an appeal bond "in a case in which it has no direct interest."[77] In Iowa, it was decided that a corporation in the "general freight and transfer business" was not justified in becoming surety to a brewing company for payment of beer by a saloon to which the brewing company sold its product. There is a great lack of harmony in the decisions, but they do not differ so much on the rule of law as they do in applying the rule of law to different sets of facts. Of recent years it has become prevalent for one railroad company to guarantee the bonds of another railroad company in which it is interested. These agreements are ordinarily upheld, especially where the guarantor owns a considerable block of stock in the other railroad.

108. **Power to act as trustee.**—In the early days of corporation law it was thought that a corporation could not act as a trustee. Trusts are administered in courts of equity, which operate upon the conscience of the trustee. The old writers thought that a corporation, therefore, could not possibly be a trustee. They said, the corporation has no soul or conscience, and how can it possibly be governed by equitable and conscientious obligations? This reasoning today is exploded as artificial and unsound. A corporation today may act as a trustee; in fact, trust companies are very common. Corporations also act as exec-

[76] Winterfield v. Cream City Brewing Co., 96 Wis. 239, 71 N. W. 101.
[77] Best Brewing Co. v. Klassen, 185 Ill. 37, 57 N. E. 20.

utors, administrators, and guardians. Frequently their right to assume these personal relations is the result of statute; but in many states this result has been reached without any necessity for statutory intervention. It is very desirable to have a corporation act as trustee. In the first place, the corporation, unlike the individual trustee, does not die. In the second place, it is ordinarily more reliable and responsible. Especially in our large cities today, a great part of the administration of trust estates is in the hands of trust and guaranty corporations.

109. **Power to make by-laws.**—A by-law might be defined as a rule for the internal government and management of the corporation, regulating the internal affairs of the corporation, its directors and officers. By-laws are ordinarily drawn up by the stockholders. They correspond in a general way to the rules of conduct in a literary society or similar organization. By-laws must be reasonable in order to be valid. Third parties dealing with a corporation are not governed by its by-laws in ordinary cases.

110. **Power to make an assignment for the benefit of creditors.**—A corporation has the same right to make an assignment for the benefit of creditors as a private person. This right exists inherently in all corporations unless specially forbidden. In the absense of a prohibitory statute, the corporation may also prefer certain creditors, provided it does so in good faith. At common law, an individual has an unrestricted and absolute right, in the absence of statute, to make preference among his creditors. There seems no logical reason why artificial persons,

corporations, should not also have this right. In most states preferences are today forbidden or strictly limited.

111. **Power to take by bequest or devise.**—A corporation has always been held to have power to take a bequest of personal property under a will. Likewise, a corporation can take an equitable interest in real estate by devise. However, at common law, a corporation has no power to take a legal interest in real estate by devise. Corporations are expressly excluded in the original Statute of Wills. (34 Henry VIII, C. 5.) Consequently, lands could not be devised to them. In many American jurisdictions, the provisions of the English statute have been followed. In most states, however, in the absence of a special statute to the contrary, corporations are capable of taking a devise of land for any purpose necessary and suitable for carrying on the corporate business. In other states, the same result is reached under statute, although in some of these states there is a strict limit as to the amount of real estate which may be devised to a corporation. Suppose a corporation is unauthorized to take real estate by devise under the laws of the state creating it. Can it take land in another state by devise where corporations are allowed to take real property by will? This question has generally been answered in the affirmative, though in some states, including Illinois, the answer of the court is in the negative.

112. **Power to acquire its own shares.**—One of the most mooted questions in the law of corporations is whether a company has the right to acquire its own

shares of stock. The decided weight of authority in the United States holds that a corporation can take its own shares provided it does so in good faith and without any injury to its creditors. In England, and in several American jurisdictions, including Maryland and Ohio, this power is denied, and a purchase by the corporation of its own stock is regarded as ultra vires. In an early New York case,[78] the board of directors of a banking corporation passed a resolution that all stockholders indebted to the bank might pay their debts to it in shares of stock of the bank at a certain figure. About half of the stock of the bank was thus surrendered. This, of course, amounted to a purchase by the bank of its own shares; but the court held that there was no ground for questioning the validity of the transaction and that no rule of common law forbade it. If the purchase of its own shares operates to the injury of creditors, or if it is done for any other fraudulent purpose, the transaction is illegal. In some cases a distinction is made between a purchase with funds representing capital from a purchase with accumulated surplus; the latter being held valid, whereas the former is condemned.

In the English cases, for example, the leading case of Trevor v. Whitworth,[79] there are several reasons given for the decision reached, that a corporation cannot acquire its own shares. First, it is said that if the corporation acquires its shares with a view to selling them again, this is an unauthorized specula-

[78] City Bank of Columbus v. Bruce, 17 N. Y. 507. See also Chicago, etc., R. Co. v. President of Marseilles, 84 Ill. 643, LEADING ILLUSTRATIVE CASES.

[79] 12 App. Cas. 409.

tion in stock, amounts to a trafficking in shares, and is ultra vires. On the other hand, if it is not intended to reissue the shares, then the purchase of the stock amounts to an unauthorized reduction of its own capital. The English courts insist that the dilemma is perfect, and that in either event the purchase of its own stock by a corporation is unlawful. It is also insisted that to give a company such power tends to encourage fraud and deceit.

Even in England and the jurisdictions which follow the English rule, however, an exception to the rule that a corporation cannot traffic in its own stock is admitted to exist, whereby a corporation is allowed to take its own stock in satisfaction of a debt due to it. This exception is supposed to rest on a necessity which arises in order to avoid loss.[80]

113. **Power to acquire shares of stock of other corporations.**—In England and in a few American jurisdictions, including Maryland and New Jersey, it is held that one business corporation has a right to purchase and hold shares of stock in another trading corporation.[81] On the other hand, the general rule in the United States is that one business corporation has no implied power to acquire or hold stock in another corporation. This is forbidden, whether the stock is purchased as a permanent investment, for speculation, or for the purpose of controlling or managing the other corporation. In a few cases the purchase is forbidden, not because the purchase is

[80] Coppin v. Greenlees & Ransom Co., 38 Ohio St. 275.

[81] In re Asiatic Banking Corp., L. R. 4 Ch. App. Cas. 252 (Eng.); Booth v. Robinson, 55 Md. 419.

of stock in another corporation, but because the business of the corporation whose stock is purchased is of a distinct kind and character. Most states, however, forbid the purchase of stock in any other corporation. There are two exceptions to this rule: First, a certain class of corporations may rightfully invest their surplus funds in stock of other corporations; for example, a religious or charitable corporation may lawfully invest its surplus in the stock of a corporation, and even if this power is not expressly mentioned in the charter, it is necessarily implied. In the same way, an insurance company or a savings bank may rightfully invest its capital or deposits in this manner. Such investments are in the line of their business and are essential in order to carry it on. On the other hand, the ordinary trading corporation is incorporated to do the business of trading, and investing its funds in that of other corporations is not in the line of its business, and is ultra vires. The second exception is that under extraordinary circumstances it may become necessary for the ordinary corporation to acquire stock in another corporation, as, in satisfaction of a valid debt or by way of security. Under these circumstances, where it is necessary to prevent loss or to safeguard the payment of a debt, the stock in another corporation may legitimately be taken.

114. **Same subject—The holding company.**—Of recent years this question of the right of one corporation to acquire stock in another corporation has become very important because of the organization of great holding companies which are organized solely

for the purpose of acquiring stock in other corporations. In some states, the validity of the holding company is affirmed. But in Illinois, for example, and in several other states, the holding company is condemned as monopolistic in tendency. Thus, in the celebrated case of People v. Chicago Gas Trust Co.,[82] the Supreme Court of Illinois held that a corporation could not be organized to purchase and hold stock in other similar corporations. This is especially true where the tendency of the holding company is to prevent freedom of competition or to bring about an improper restraint of trade; but in numerous decisions, the holding company has been forbidden where no question of competition has entered into the case.[83] In general, the tendency of the common law is to discourage the holding company, although the numerous decisions to the effect that one corporation may rightfully invest its funds in the stock of other corporations tend to cloud and befog the situation.

115. **Power to enter into a partnership.**—The general rule is that a corporation has no power to form a partnership in the absence of statutory authorization. "A partnership and a corporation are incongruous."[84] In a partnership, each member has authority to bind the firm. A corporation must act through its directors or authorized agents. If a corporation is a member of a partnership, it may be bound by the acts of any other member of the partnership, and this would result in giving to some one

[82] 130 Ill. 268, 22 N. E. 798.

[83] Woodberry v. McClurg, 78 Miss. 831, 299 So. 514.

[84] Mallory v. Hananer Oil Works, 86 Tenn. 598, 8 S. W. 396, LEADING ILLUSTRATIVE CASES.

outside of the corporation the power of management and control over the corporation,—which would be wholly inconsistent with the nature of a corporation and with its duty to the state. The whole policy of the law creating and regulating corporations looks to the exclusive management of the corporate affairs by its directors and officers. This management must be exclusive, and any arrangement by which the control of the affairs of the corporation is taken from its directors and authorized officers, and vested in others, would be hostile to the policy of our corporation laws. Besides, if a corporation could enter into a partnership, this might involve the corporation in new responsibilities through agents over whom it has no control whatever. For these reasons, corporations are unauthorized to enter into partnerships either with other corporations or with private individuals. Another reason why this is forbidden is because corporate trusts and monopolies would be furthered if corporations had the right to enter into partnerships with each other.

On the other hand, it has been held that corporations may enter into joint transportation contracts where they have connecting facilities. In California, it was held that a corporation could enter into a partnership with an individual, provided that the entire management was left to the corporation. In Rhode Island, it has been held that a corporation may lawfully enter into a partnership terminable at will.

116. **Same subject—Accounting.**—Where a corporation has entered into a partnership unlawfully with another corporation or with an individual, it is

held bound to make an accounting.[85] Accordingly, where a corporation and an individual have assumed to enter into partnership and jointly transact business together, they may recover upon obligations made to them in their partnership name. The tendency of the law is apparently liberal, and in many cases, the contract is upheld though the clear result is to impose upon the company the liability of a partner.

117. **Power to transact a distinct business not covered by the corporate charter.**—A corporation has no power to transact any separate and distinct business which is not expressly or impliedly authorized in its charter. This does not mean, however, as we have seen, that a corporation cannot transact a business incidental to, or consequential upon, its authorized business. A hotel company is unauthorized to engage in a real estate business. A dry goods company is unauthorized to maintain and operate a street railway. A corporation organized to manufacture articles is not authorized to conduct a selling agency for products manufactured by another concern. A railroad company is unauthorized to purchase and control a steamboat line; though it might, with perfect propriety, purchase and operate a ferryboat system to be run in connection with its railroad. The question is, after all, largely a question of fact as to what is a distinct and separate business.

118. **Power to practice law and medicine.**—A corporation, the courts uniformly hold, may not

[85] Wilson v. Carter Oil Co., 46 W. Va. 469, 33 S. E. 249; Cleveland Paper Co. v. Courier Co., 67 Mich. 152, 34 N. W. 556.

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practice law.[86] The reason for this is that the right to practice law is personal and for that reason cannot be conferred upon an artificial body. In the same way, it has been held that a corporation cannot practice medicine.[87] It might be added that, in general, corporations cannot be created to carry on purely personal services. This is self-explanatory. In short, the analogy between natural and artificial persons must not be pushed too far or it results in manifest absurdity.

119. **Miscellaneous powers.**—Suppose a bank has employed an official for many years and he has served it loyally. On his death may the bank pay a pension for five years to the family of the deceased? It was held that this was within the powers of the banking corporation. Suppose an insurance company voluntarily pays a loss for which it is not liable. Plainly, it may be good business to do so and a very wise and sensible policy for the insurance corporation to adopt. The payment was held intra vires. Can a hotel company subscribe to a fund in order to bring a military encampment to the town and thus attract many additional guests? The Supreme Court of Illinois held that it could, although in a Massachusetts case an apparently contrary result had been reached. Can a hotel company maintain and operate a barber shop? This has been answered in the affirmative. It was recently held in Ohio that it is within the implied powers of a railroad company to run and

[86] Matter of Co-operative Law Co., 198 N. Y. 479, 92 N. E. 15.

[87] People v. Woodbury Derm. Inst., 192 N. Y. 454, 85 N. E. 697; State Electro-Medical Inst. v. State, 74 Neb. 40, 103 N. W. 1078.

manage a relief and accident fund for its employes. And this decision seems entirely reasonable and a very sound policy for a large corporation to adopt. In a recent Maryland case, a contract whereby a railroad company guaranteed the payment of the interest and dividends on the bonds and stock of a large hotel corporation whose property was located along the line of its railroad, was regarded as ultra vires; but if the railroad company held stock in the hotel company or was otherwise interested therein, the result might have been different. The mere fact that a thing proposed to be done might be very profitable does not authorize its doing by a corporation. In a leading English case, accordingly, Lord Langdale issued an injunction restraining the directors of a railroad company from promoting and financing a steamship company to operate between the terminus of the English railroad at Harwich and the ports of northern Europe.[88] In a well-known Massachusetts case, the Supreme Judicial Court of that state decided that a glass manufacturing corporation possessed power to purchase and re-sell glass articles in order to hold on to its trade pending repairs which were being made to its factory. A corporation ordinarily is without power to contribute to political campaign funds or other similar subscriptions, such as church bazaars and the like. In the last analysis, whether an act is intra vires or ultra vires depends largely upon what is the approved usage or custom among business men in the particular community at the period.

[88] Colman v. Eastern Counties R. Co., 10 Beav. 1 (Eng.).

120. **Modern tendency in construing corporate powers.**—Of late years, a very decided tendency has manifested itself to interpret as liberally as possible the powers of the ordinary private corporation for pecuniary profit. The reason for this apparently is that, after all, an ordinary corporation is a private association and one in which the general public policy of the state is not concerned to any considerable extent. A decided tendency has developed even in conservative jurisdictions to regard the question of ultra vires as one between the corporation, on the one hand, and the sovereign state, on the other, and to declare that if the sovereign state does not interfere, the act will ordinarily be sanctioned as a valid one. The wisest and safest course for an attorney to pursue, however, is to draft the articles of association with great care so as to confer upon the corporation every power which it may conceivably desire to possess and exercise. If this is done, no question of want of corporate power can thereafter arise to trouble the associates.

CHAPTER VIII.

ULTRA VIRES TRANSACTIONS.

121. **Definition of ultra vires.**—An ultra vires act is one which is beyond the corporate powers. In other words, it is an act which the articles of association do not authorize either expressly or by necessary implication. As has been seen, a corporation possesses the power, the physical might, to perform an ultra vires act. It, however, has not the right so to do. As to the exact nature of an ultra vires act, the decisions are in hopeless confusion. Some courts regard an ultra vires act as they would an illegal act. Others regard it as a mere nullity. Still others regard it as perfectly valid and binding unless the sovereign state sees fit to interfere. Logically, the articles of association are, as it were, the area beyond which the action of the company cannot properly go. If a corporation, for example, enters into an ultra vires contract, this is an act absolutely beyond the powers of the company. If it is ultra vires at its beginning, it was void because the company could not rightfully make the contract. Even if every shareholder of the company had been present and had consented, and had authorized the directors to enter into the various contracts, nevertheless it would be unauthorized. The reason is that the shareholders would, thereby, be seeking to do an act which they were not authorized to perform under their corporate

charter. But many courts, as we shall see, refuse to go to this extent in their interpretation of ultra vires transactions, and assign strong reasons for their course. Perhaps no two courts are in complete accord on the subject. The law is in an extremely chaotic condition.

122. **Ultra vires distinguished from illegality.**—An ultra vires act is not necessarily an illegal act. The two are not the same. Much of the confusion in the decisions has arisen from the failure to distinguish between the two. An ultra vires act may also be an illegal act. The two overlap, but they are not the same. To illustrate: Suppose that a corporation organized to run a retail butcher business contracts to purchase two tame elephants. By no stretch of the human imagination could this be called an illegal act. It is neither inherently wicked nor forbidden by positive statute. At most, the purchase is simply unauthorized. The butcher company is doing something which is ultra vires and quite unauthorized by the terms of its charter; but it surely is doing nothing illegal. The contract is neither *malum prohibitum* (a wrong which is forbidden), or *malum in se* (an inherently vicious act contrary to good public morals). On the other hand, let us suppose that a corporation organized to operate a department store, hires John Doe, a notorious criminal, to murder a competing rival, one Jones. Doe proceeds to murder Jones. This contract is not only ultra vires of the department store, but positively illegal as well. The distinction between the two,—*ultra vires,* on the one hand, and *illegality,* upon the

other,—seems obvious. The distinction is of great importance, not only theoretically, but from the practical point of view, as well. The law is well settled that there never can be a recovery upon an illegal contract. As an ultra vires contract is not necessarily an illegal one, the rules which are applicable to illegal contracts are not at all decisive in the cases of ultra vires contracts.[89]

123. **Development of the doctrine.**—Originally, ultra vires corporate acts were treated just as though they were illegal acts. Most of the early corporations were more or less public in their nature, and it was, therefore, highly important to keep them within their chartered powers. As corporations increased and entered the domain of the purely private business and partnership, it was seen that this rigid rule did not work fairly. Ultra vires acts were then treated as void but not necessarily as illegal. Where it was necessary, in order to do justice, a recovery on an ultra vires contract was allowed, for example. Of recent years, the courts seem to be inclining to the view that the question of corporate power cannot be raised collaterally, but that only the sovereign state may raise the question.

In this respect, the doctrine of ultra vires is manifesting a tendency to work itself out upon the same general lines as the de facto corporate doctrine. It has been seen that the question of irregular or defective organization is permitted by the courts, in many jurisdictions, to be raised by the state alone. So, in several jurisdictions, the courts are leaning to

[89] Ashbury Ry. Carriage & Iron Co. v. Riche, 9 Ex. 224, 7 H. L. 653 (Eng.).

the view that the state, and it alone, may challenge the validity of the exercise of a given power by a corporate body.

124. **Acquisition of property.**—Suppose that a corporation takes a conveyance of real estate which is unauthorized by its charter. Is the conveyance to the corporation void? To-day, the courts are almost unanimous in answering this question in the negative. "In the absence of a clear expression of legislative intention to the contrary, a conveyance of real estate to a corporation for a purpose not authorized by its charter, is not void, but voidable, and the sovereign alone can object. Neither the grantor nor his heirs nor third persons can impugn it upon the ground that the grantee has exceeded its powers." This language of Mr. Justice Hughes, in a recent decision by the Supreme Court of the United States,[90] is in accord with the overwhelming weight of modern authority. Thus, although the national banking statute by clear implication forbids a national bank from making a loan upon real estate, the security is not void. The disregard of the act of Congress only lays the bank open to proceedings by the government for exercising powers not authorized by law. The general rule is, that where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign state alone can object. The conveyance, in other words, is perfectly valid until assailed in a direct proceeding instituted by the state, through its Attorney General, or other legal officer, for that pur-

[90] Kerfoot v. Farmers' & Merchants' Bank, 218 U. S. 281, 54 L. Ed. 1042.

pose.[91] This rule, while recognizing the authority of the state which has created the corporation and to which the corporation is amenable, has the beneficial effect of assuring the security of titles to real estate and of preventing the injurious consequences which would otherwise result. The title of the corporation to the real estate and its right to enjoy the same cannot be inquired into collaterally in actions between private parties or between the corporation and private parties. It can be questioned only by the state.

125. **Same subject—By devise or bequest.**—Suppose that a corporation is forbidden by statute to take, by devise or bequest, property in excess of a certain amount. Suppose that it has already that amount of property. What is the legal status of property thereafter devised or bequeathed to the corporation? There are two distinct views. The first view, which prevails in Maine, Massachusetts, Maryland, and the federal courts, regards the bequest or devise as valid unless the state interferes. It forbids the question to be raised collaterally. The other view, following a famous New York case,[92] holds that the corporation has absolutely not the capacity to take the property, and that the devise or bequest is void. To illustrate, let us suppose that a section in the charter of a college provides that it "may take and hold by purchase, gift, devise or bequest, personal and real estate in all not exceeding one million dollars in value, owned at any one time." Further, suppose

[91] Leazure v. Hillegas, 7 Serg. & R. 313 (Pa.); Hamsher v. Hamsher, 132 Ill. 273, 23 N. E. 1123.

[92] Matter of McGraw, 111 N. Y. 66, 19 N. E. 233.

that X dies, devising to the college in his last will and testament the sum of five million dollars in real and personal property; and assume that at the time of testator's death, the college owns property to the full amount of the one million dollars' worth which it is authorized by its charter to hold. Can the college take under the will? In Massachusetts and the states which agree with it, the question would be answered in the affirmative. The same result would be reached, in other words, in the case of a devise or bequest, as is reached everywhere in the case of a title by grant or conveyance. In the absence of interference by the state, the corporation would be left alone. In a United States Supreme Court case,[98] Mr. Justice Gray said that "restrictions imposed by the charter of a corporation upon the amount of property that it may hold, cannot be taken advantage of collaterally by private persons." On the other hand, in New York, Texas, Rhode Island and several other jurisdictions, the corporation would be regarded as incapacitated to take or hold under the will. If land were devised, the devise would be regarded as void, and the title thereto would automatically vest in the heirs of the deceased. As said by Chief Justice Durfee, of Rhode Island, "the question is, of course, a question of legislative intent. It seems to us that the limitations on the power of the corporation to hold is necessarily an implied limitation on the power to take, for why take what it cannot hold? Indeed, the very act of taking involves

[98] Jones v. Habersham, 107 U. S. 174. See also Hubbard v. Worcester Art Museum, 194 Mass. 280, 80 N. E. 490, LEADING ILLUSTRATIVE CASES.

an act of holding, momentarily at least. And, if the illustration be permissible, a vessel which is as full as it can *hold* is incapable of *taking* any more."[94] The two lines of decision are irreconcilable. The weight of authority is probably with the New York courts, but the recent decisions in several states indicate a very manifest tendency to regard such devises and bequests as good against everyone but the commonwealth.

126. **Same subject—Mortmain doctrine.**—In the early days of the common law, the courts looked with little favor upon the acquisition of real property by corporations. Mortmain, literally, means "dead hand." The significance of the term lies in the circumstance that a corporation was supposed to hold on to property, once it acquired it, with the grip of a dead man's hand. This naturally was frowned upon as tending to restrain the free alienation and circulation of property. A decided mortmain policy prevails to this day in many American states, and this circumstance serves to explain, for example, the New York decision. As said by Judge Peckham, who delivered the opinion in the Cornell University case,[95] "We have a decided mortmain policy. It is found in our statute in relation to wills prohibiting a devise to a corporation unless specially permitted by its charter or by some statute to take property by devise." In states where no mortmain policy exists, it is submitted that the reasoning of the Massachusetts decision is preferable. In the ultimate analy-

[94] Wood v. Hammond, 16 R. I. 98, 17 Atl. 324, 18 Atl. 198.
[95] See note 92.

sis the question is almost entirely one of local public policy and of legislative intent.

127. **Transfer of property.**—Strange to say, the subject of ultra vires transfers of property by corporations has received comparatively little legal attention. Most of the cases which have arisen involve the right of a quasi-public corporation to alienate property which it needs in order adequately to perform its services and obligations to the public. In such cases it is clear that the conveyance, for reasons of public policy, is a nullity. In Commonwealth v. Smith,[96] the Troy & Greenfield Railroad Company, in Massachusetts, executed a mortgage of its franchise, railroad and all other property. The court held the mortgage void, and, pointing out that every mortgage may become an absolute conveyance by foreclosure, held that the mortgage as well as the bonds which it was executed to secure were irregular and illegal. In the same way, where religious corporations are restrained from alienating their real estate, an unauthorized conveyance of its property by a church passes no title to the grantee.[97]

On the other hand, an ultra vires conveyance by an ordinary private corporation passes title to the grantee. There are very few decisions in point, but in a leading California case Chief Justice Sawyer so held.[98]

128. **Executory contracts.**—Where a contract is purely executory, that is, where nothing has been

[96] 10 Allen 448 (Mass.).
[97] Madison Ave. B. Church v. Bapt. Church, 73 N. Y. 82.
[98] Miners' Ditch Co. v. Zellerbach, 37 Cal. 543.

done by either party, there cannot be any recovery either by or against the corporation for breach of an ultra vires contract. A mere executory ultra vires contract can never be made the foundation of an action either by or against the corporation. In an Alabama case, it was held that a corporation could not sue on an executory contract and recover certain land which defendants had agreed to convey to it. In a Missouri case, a corporation organized to carry on a dairy business assumed to operate oyster wagons and sell oysters therefrom. It employed the defendant as a driver and he breached the contract of employment. It was held that there could be no recovery as the contract remained purely executory. In a famous decision by the Supreme Court of the United States,[99] a corporation sought to obtain in equity the specific performance of a contract to convey lands to it. In deciding against the corporation, on the ground that the contract still remained unexecuted, Justice Miller said: "While a court might hesitate to declare the title to land already received and in the possession and ownership of the company void on the principle that they had no authority to take such lands, it is very clear that it will not make itself the active agent of the company in violating the law and enabling the company to do that which the law forbids." There are a few cases which hold that even an executory contract can be attacked only by the state, but these decisions constitute a very feeble minority.

The theory upon which our courts refuse to sanction a recovery upon an executory ultra vires corpo-

[99] Case v. Kelly, 133 U. S. 21.

rate contract is very simple. After all, a corporate contract which is ultra vires is an unauthorized contract and one which the state has not permitted or sanctioned. Therefore, the courts, which are an agency of the state, should not lend their aid in order to carry out such a contract which is still wholly unexecuted. For example, suppose that a retail grocery corporation has agreed to purchase ten thousand yards of silk from X. The corporation refuses to take the silk when X delivers it on the ground that it is unauthorized to enter into such a contract. Note that the contract still remains entirely executory. The courts are practically unanimous in holding that X cannot recover damages from the corporation. Or, take the reverse situation. Suppose that X refuses to deliver the silk to the corporation. The corporation cannot sue and recover damages for the breach of contract. In other words, the courts will not lend their aid in order to enable parties to effectuate an ultra vires contract. In fact, it is the duty of either party to withdraw from such a contract, and when this is done no action for breach of contract will lie at law, and in equity specific performance will not be decreed.[1]

There are three main reasons why a corporation cannot sue or be sued upon such an ultra vires contract: (1) the interest of the public that the corporation shall not exceed the powers granted to it; (2) the interest of the shareholders that the capital stock of the corporation shall not be subjected to the risk of enterprises not contemplated by the corporate

[1] Nassau Bank v. Jones, 95 N. Y. 115.

charter, and therefore not authorized by the stockholders when they subscribed for stock in the company; (3) the duty of every one who enters into a contract with a corporation to take notice that it is a creature with limited powers and to take notice of the legal limits of its powers.[2]

129. **Executed contracts.**—Just as the court will not interfere with executory ultra vires contracts, so it will not interfere with ultra vires contracts when fully executed by those parties. It will not disturb such an executed contract upon the complaint either of the corporation or of the other contracting party, but the court will leave the parties in *statu quo,* that is, where they have placed themselves by their own actions and where it finds them. Thus, in Long v. Georgia Pacific R. Co., L and his wife executed to the railway company a deed of certain valuable mineral property, and received a valuable consideration therefor. Subsequently, L brought a bill in equity to rescind the conveyance on the ground that the corporation was without power to purchase and hold the land or the mineral interests in the land. The bill sought further to have the deed declared void because of this incapacity of the corporation, and to have it canceled as a cloud upon L's title. The corporation demurred. The court decided that, as the contract was duly executed on both sides, it would not interfere. McClellan, J., said: "The law will not interfere, at the instance of either party, to

[2] Railway Companies v. Keokuk Bridge Co., 131 U. S. 371, LEADING ILLUSTRATIVE CASES; Chicago, etc., Ry. Co. v. Union Pacific R. Co., 47 Fed. 15, LEADING ILLUSTRATIVE CASES; Miners' Ditch Co. v. Zellerbach, 37 Cal. 543, LEADING ILLUSTRATIVE CASES.

undo that which it was originally unlawful to do, and to the doing of which, so long as the contract to that end remained executory, neither party could have coerced the other."[8] The court left the parties where they had placed themselves.

130. **Partially executed contracts.**—Where a contract has been partially executed, there are two views as to its legal effect. The rule maintained in the Supreme Court of the United States, followed by several state courts, is that an ultra vires contract is absolutely null and void, and that no action in any form, shape or manner can be maintained upon the contract itself. In New York and in perhaps the majority of state courts, the rule is that if the contract is partially executed, the party who has performed on his part may sue and recover upon the contract, and the other party is estopped from denying the validity of the agreement. Suppose, for example, an iron manufacturing corporation orders three tame lions from X, an animal trainer. Suppose X delivers the lions, and they are left in the possession and control of the corporation. In the federal courts, X could not sue and recover from the corporation the agreed purchase price of the lions. In other words, X would have no remedy upon the contract itself; whatever remedy X would have, would be in an action of quasi-contract, to recover the reasonable value of the lions from the corporation and to prevent the unjust enrichment of the company at the expense of X. But in New York, X would

[8] Long v. Georgia Pacific R. Co. 91 Ala. 519, 8 So. 706, LEADING ILLUSTRATIVE CASES.

be allowed to recover the agreed purchase price of the lions in an action brought against the iron corporation for breach of contract. The iron corporation, having received the benefits of the contract, namely, the lions, would be estopped from raising the defense that it was unauthorized by its charter to purchase animals of that sort. It should not lie, says the New York court, in the mouth of the corporation to say that it is without authority, where it has received and retained the benefits of the contract. Consequently, in New York, the partially executed ultra vires contract is unquestionably enforcible, according to its terms, by the party who has performed on his, or its, side.

131. **Same subject—Federal or strict rule.**—In the federal courts, the view is taken that there can never be a recovery *upon the contract itself*. As said by Mr. Justice Gray, in Central Transportation Co. v. Pullman's Palace Car Co., "All contracts made by a corporation beyond the scope of its powers are unlawful and void, and no action can be maintained upon them in the courts, and this upon three distinct grounds: The obligation of everyone contracting with a corporation, to take notice of the legal limits of its powers; the interest of the stockholders not to be subjected to risks which they have never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law."[4] A contract which is unlawful and void because beyond the scope of the corporate powers does not become unlawful and valid

[4] 139 U. S. 24, 35 L. Ed. 55.

by being carried into execution. No action, under any circumstances, can be maintained upon the unlawful contract or according to its terms. Thus, where a railroad corporation acted in excess of its powers and leased all its property to another corporation, it was held that the lessor could not recover rental which had accrued under the contract of lease.

132. **Same subject—Recovery in quasi-contract.** —In the instance just put, what is the remedy of the lessor corporation? The answer of the Supreme Court of the United States is that the lessor should disaffirm the contract of lease and sue to recover, as on a *quantum meruit* (how much worth), the reasonable value of what the defendant has actually received the benefit of. To maintain such an action is, of course, not to affirm but to disaffirm the ultra vires contract. It recognizes that there can be no recovery upon the contract itself. But, in order to do justice between the parties it permits property or money parted with on the faith of the unlawful contract, to be recovered back or compensation to be made for it.[5] It can thus be seen that the federal courts, while they do not permit a recovery upon the contract itself, nevertheless recognize that a party should not receive and retain property without making compensation for it, and accordingly resort is had to the doctrine of quasi-contract, a promise is implied, and a recovery for the reasonable value of that which has been received and retained is permitted.

[5] Pullman's Palace Car Co. v. Central Transportation Co., 171 U. S. 138, 43 L. Ed. 108.

133. **Same subject—New York or liberal rule.**—In New York and in many other states, one who has received from a corporation the full consideration of his promise cannot avail himself of the objection that the contract thus fully performed by the corporation was ultra vires, that is, not within its chartered privileges or powers. The New York courts insist that it would be contrary to the first principles of equity to allow such a defense to prevail in an action by the corporation. In a leading case,[6] X corporation entered into a contract with a corporation organized to manufacture firearms and other implements of warfare, to furnish to it twenty thousand railroad locks. The plaintiff, the arms company, made and delivered ten thousand locks under the contract and as to the residue the contract was rescinded by mutual consent. It was conceded that the manufacturing and selling of railroad locks was not within the purposes for which the arms company was incorporated, or within the powers conferred upon it by its charter. Yet it was unanimously held that the plea of ultra vires could not prevail as the defendant had received the full benefit of the contract. Allen, J., said: "It is now very well settled that a corporation cannot avail itself of the defense of ultra vires when the contract has been, in good faith, fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract. * * * The same rule holds *e converso*. If the other party has had the benefit of the contract fully performed by the cor-

[6] Whitney Arms Co. v. Barlow, 63 N. Y. 62, LEADING ILLUSTRATIVE CASES.

poration, he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation." In other words, a party who has had the benefit of the ultra vires contract cannot be permitted, in an action founded upon it, to question its validity.[7] In a Colorado case, the plaintiff insured against loss or damage by hail in an insurance company authorized by its charter only to insure against loss by fire or lightning. The premium was paid. A heavy loss occurred. The corporation denied liability, insisting that it was without power to enter into the contract of insurance in question. It was held that plaintiff could recover.

The New York rule has been criticized because it allows a recovery upon contracts which are concededly unauthorized. The answer made by the New York courts is that this is fully as logical as to deny a recovery upon the contract, as the federal courts do, and in the next breath, permit a recovery upon an implied contract. The New York courts insist that the federal rule is "a mere evasion." This much is to be said in behalf of the New York rule: that it is a shorthand cut to justice. Besides, the measure of recovery in the action of quasi-contract, to which the federal courts resort, is seldom substantially different from the agreed contract price.

134. **Same subject—Intermediate rule.**—In a few jurisdictions, apparently including Illinois, the courts draw a distinction between want of power, on the one hand, and abuse of power, on the other.

[7] Bath Gas Light Co. v. Claffy, 151 N. Y. 24, 45 N. E. 390; Wright v. Pipe Line Co., 101 Pa. St. 204.

Where there is an absolute want of power to make the contract, they hold that there can never be any recovery upon the agreement itself. As said by Chief Justice Cartwright, of the Supreme Court of Illinois: "It would be contradictory to say that a contract is void for an absolute want of power to make it, and yet it may become legal and valid as a contract by way of estoppel, through some other act of the party under some incapacity, or some act of the other party chargeable by law with notice of the want of power."[8]

On the other hand, where there exists only an abuse of power and the act is within the general scope of the corporate powers, the doctrine of estoppel, as applied in New York, is invoked. Of course, the border line between want of power and abuse of power, at best, is very shadowy. The value of the distinction is questionable. If the Illinois rule means to confine the doctrine of estoppel to those cases where the contract is within the powers of the corporation, but only beyond the mere authority of its officers or agents, it is more readily understood; but the courts of that state do not seem to have confined it within these limits.

135. **Rescission of ultra vires contract.**—In a leading federal case, X railroad corporation leased its entire railroad property and franchises to the Y railroad corporation for a term of nine hundred and ninety-nine years, in consideration of the payment by the latter to the former of a certain portion of

[8] National Home Building & Loan Assn. v. Home Savings Bank, 181 Ill. 35, 54 N. E. 619.

the gross receipts. The contract was fully executed by the actual transfer of the railroad property. The Y corporation held the property and paid the stipulated consideration, from time to time, for seventeen years. Then, for the first time, the X corporation became dissatisfied and brought suit in equity to set aside and cancel the instrument as beyond the corporate powers of both companies. The United States Supreme Court, though conceding that the contract was ultra vires, decided that no suit could be maintained to set aside and cancel the contract. The parties, declared the court, should be left where they have placed themselves. The maxim that where both parties are equally to blame, the condition and position of the defendant are the better, was resorted to.[9] This decision seems open to the criticism that it forbids a corporation to renounce that portion of an ultra vires contract which as yet remains unexecuted. The decision is defended on the ground that the court should not interfere to afford affirmative release either to enforce or to set aside an ultra vires contract. It should be noted, however, with all deference to the learned court, that the reasoning of the decision is extremely confusing and apparently fails to distinguish between illegal and ultra vires contracts. The court repeatedly refers to the rules which govern illegal agreements. On the other hand, in an early Massachusetts case, the court permitted a disaffirmance and permitted the consideration money to be recovered back. In a well-known Wis-

[9] St. Louis, Vandalia & T. H. R. Co. v. Terre Haute & I. R. Co., 145 U. S. 393.

consin case,[10] an action was brought by a corporation engaged in the business of a common carrier, upon a contract for the sale of wheat to be delivered to the plaintiff's ship. One thousand dollars had been paid on account. The contract was repudiated as ultra vires, and the plaintiff sought judgment for the one thousand dollars paid on account, and for damages for breach of the contract. The plaintiff was not entitled to damages, said the court, but was entitled to the return of the consideration paid. The right of rescission was recognized.

In general, it might be said that a corporation, on principle, should be permitted to withdraw from an agreement which is ultra vires. Only in a sense is the court interfering; what is really being done is to prevent the consummation of an unauthorized agreement.[11]

136. **Modern tendencies.**—Of late years several progressive jurisdictions have insisted that the question and principle of ultra vires is closely allied to, if indeed it is not substantially identical with, the rule of law which forbids the regularity or validity of the organization of a corporation to be inquired into except at the direct instance of the state. After all, the only offense, it is insisted, is against the sovereignty of the state. If the state does not interfere, why should private persons be permitted to raise the issue collaterally? If this doctrine is adopted—that only the state can challenge the acts done under color of a corporate charter—it must necessarily pro-

[10] Northwestern Union Packet Co. v. Shaw, 37 Wis. 655.

[11] McCutcheon v. Merz Capsule Co., 71 Fed. 787, 19 C. C. A. 108.

tect an executory ultra vires contract from collateral attack as well as any other. There are only a few decisions as yet, however, which go to this extreme. One of the most notable is the Kansas decision in Harris v. Independent Gas Co.[12] In that case Judge Mason said: "The court is convinced of the soundness of the view that neither party to even an executory contract should be allowed to defeat its enforcement by the plea of ultra vires. The doctrine is logical in theory, simple in application, and just in results." If this view gains ground it will mean that the question of want of corporate power, just like the question of legality of corporate organization, may only be raised by the sovereign state. If the state is satisfied with the construction upon which the corporation acts, if the state does not intervene, if no question of public policy is involved,—no real reason is apparent why the issue should be open to question by a stranger, much less by one who has dealt with the company. It must be conceded that few courts have thus far taken this advanced but strictly logical point of view. The tendency is unquestionably, however, in this direction.

[12] 76 Kans. 750, 92 Pac. 1123.

CHAPTER IX.

CORPORATE CRIMES AND TORTS.

137. **Early doctrine.**—In the early days of the common law it was thought that a corporation could not commit a tort or be guilty of a crime. The quaint reason was assigned that a corporation had no body, hence it could not beat or be beaten; that it had no soul, and therefore could not have good or bad intentions; that it had no mind, and therefore could not entertain a malicious or wicked intention, or possess a *mens rea* (guilty mind). In the days of the Year Books there were frequent illustrations of the unfortunate result of this curious process of reasoning. Curious it certainly was. If a corporation can build bridges, if it can encircle the world with steel rails, if it can bank millions of dollars, if it can control the destinies of hundreds and thousands of human beings, surely it is not so intangible that it cannot be held to account for its crimes or torts. Suppose X, a corporation agent, commits a tort. Suppose the tort is committed on the behalf of the corporation and while engaged upon its business. The remedy against X is generally worthless. In nine cases out of ten, X is insolvent or irresponsible and a judgment against him is valueless. If there is no remedy against the corporation, the person injured will be helpless. On well settled principles of the law of agency, a master or

principal is held responsible for the acts of servants or agents within the scope of their authority, and while they are acting for the benefit of their principal. Corporations should be no exception to this general doctrine. They should be responsible not only on the contracts, but also for the torts and crimes of their agents and servants. The argument has sometimes been advanced that a corporation is a creature of limited powers, that it is not chartered to commit torts and crimes, and that, therefore, it cannot commit these. This argument, characteristic of the early days of the common law, is more plausible and ear-pleasing than it is sound. A corporation, it is very true, is not authorized by its charter to commit torts or crimes. It has not the right to commit these. But it certainly has the power to commit them, and if it does commit them it should be held responsible and should be forced to make good its wrongs. A human being is not created to commit wrongs, yet human beings frequently do so, and when they do so are held responsible. Precisely the same reasoning is applicable to artificial persons, subject only to the limitations on corporations because of their peculiar nature.

138. **Development of corporate liability.**—In the United States, even from an early date, corporations have been held liable for their torts. In fact, it might be said that it is now well settled that in an action for tort the corporation may be held responsible for damages for the acts of its agents within the scope of his employment. "Since a corporation acts by its officers and agents, their purposes, motives and intent

are just as much those of the corporation as are the things done. If, for example, the invisible, intangible essence of air, which we term a corporation, can level mountains, fill up valleys, lay down iron tracks and run railroad cars on them, it can intend to do it, and can act therein as well viciously as virtuously." The recent American cases also recognize that there is no more difficulty in imputing to a corporation a specific intent in criminal proceedings than in civil. Accordingly, corporations to-day are frequently indicted. While it is true that a corporation cannot be arrested and imprisoned in either civil or criminal proceedings, yet its property may be taken either as compensation for a private wrong or as punishment for a public offense. The prosecutions of corporations now so frequent under the criminal provisions of the Sherman Anti-Trust Act, furnish a striking illustration.

139. **Liability for torts.**—Corporations to-day, it is held, may be held liable in damages for assault, battery, false imprisonment, trespass, and similar torts committed by the corporate representatives while acting for it. A corporation can, of course, act only through its servants or agents; and for their torts, committed while acting in behalf of the corporation, the legal entity is held responsible.[13] By the overwhelming weight of authority, a corporation is held liable for torts even though arising from an action that is ultra vires of the corporation.[14] As said by the

[13] Eastern Counties R. Co. v. Broom, 6 Exch. 314 (Eng.), LEADING ILLUSTRATIVE CASES; Brokaw v. New Jersey R., etc., Co., 32 N. J. Law 328, LEADING ILLUSTRATIVE CASES.

[14] Nims v. Mt. Hermon Boys' School, 160 Mass. 177, 35 N. E. 776.

Supreme Judicial Court of Massachusetts: "It is a general rule that corporations are liable for their torts as natural persons are. It is no defense to an action for a tort to show that the corporation is not authorized by its charter to do wrong. Recovery may be had against corporations for assault and battery, for libel and for malicious prosecution, as well as for torts resulting from negligent management of the corporate business. If a corporation by its officers or agents unlawfully injures a person, whether intentionally or negligently, it would be most unjust to allow it to escape responsibility on the ground that its act is ultra vires." In the case where this language was employed, an educational corporation had assumed to operate a public ferry and to carry passengers thereon for hire. This business was, of course, ultra vires. X took passage on one of the ferry boats and was injured negligently. First, it was held that a corporation could commit a tort; and second, it was held that although the business of running a ferry boat was ultra vires, the corporation should be made to respond in damages. The point is that the corporation while running the ferry boat and taking the profit from so running it, accepted the plaintiff as a passenger to be transported, did so negligently, and therefore should be held liable. This is in accord with the general rule that corporations are held liable for torts whether they are committed in the course of an intra vires or of an ultra vires undertaking. The rule might properly be formulated that corporations are liable for every wrong which they commit, and that in such

cases the doctrine of ultra vires has no application whatever.[15]

140. **Same subject—Torts involving malice.**—Even in recent years it has been contended that a corporation cannot be held responsible for a tort in which malicious intention is an essential element of the offense. In Vance v. Erie Railroad Co.,[16] an action of trespass on the case for malicious prosecution was brought against the Erie Railroad Co. It maintained that it was an ideal entity, a mere fiction of the mind, and hence incapable of entertaining malice, which is a requisite in an action of tort for malicious prosecution. This argument was unanimously overruled. Corporations, said the court, had been held liable for false and fraudulent representations, for maliciously obstructing a party in its business, and for maintaining a vexatious suit, "in each of which actions an intent of the mind is quite as much involved as in an action for malicious prosecution." Corporations have frequently been held liable for malicious libel and slander.[17]

It must appear, however, that the corporation had expressly directed or authorized the agent to speak or write the untrue words in question. If this does not appear, the corporation is not liable. In Green v. London, etc., Omnibus Co.,[18] which was an action for wrongfully and maliciously annoying the plain-

[15] National Bank v. Graham, 100 U. S. 699, 25 L. Ed. 750; Chesapeake & Ohio R. Co. v. Howard, 178 U. S. 153, 44 L. Ed. 1015.

[16] 32 N. J. Law, 334, LEADING ILLUSTRATIVE CASES.

[17] Behre v. National Cash Register Co., 100 Ga. 213; Citizens Life Assurance Co. v. Brown, 1904, App. Cas. 423 (Eng.).

[18] 7 C. B. (N. S.) 290 (Eng.).

to the effect "that there are some crimes, which in their nature cannot be committed by corporations." The Supreme Court, however, indicates that most crimes can be committed by corporations and explodes the old doctrine that a corporation is immune from punishment. True, the corporation cannot be locked up in jail. Neither can it be tied up to the whipping post. But it can be fined, its charter can be taken away, and in addition, its guilty agent can also be personally punished. It is not enough to fine a few individual corporate agents. In fact, it is a part of the public history of our times that the statutes against rebating, for example, could not be effectually enforced so long as individuals only were liable to punishment. It is necessary to punish the corporation as well. Otherwise, the law would be shutting its eyes to the patent fact that the great majority of big business transactions are being carried on through these artificial bodies. The modern tendency is very emphatically to hold corporations liable in criminal proceedings, and this includes proceedings for criminal contempt as well.[28]

143. **Same subject—Crimes involving malicious intent.**—As to whether a corporation can be held liable for a crime involving a wicked and malicious intent, the authorities are in conflict. Logically, there seems no reason why the intent of its officers and agents cannot lawfully be attributed to the corporation. In a few cases this has been done. In an indictment of several corporations under the Sherman Anti-Trust Act it was decided that they could

[28] Telegram Newspaper Co. v. Commonwealth, 172 Mass. 294, 52 N. E. 445.

be liable criminally for the offense of conspiracy.[24] In reaching this conclusion, Judge Hough remarked: "It seems to me as easy and logical to ascribe to a corporation an evil mind as it is to impute to it a sense of contractual obligation." In a recent case, the New York Herald Company was indicted for "knowingly depositing" an obscene and unmailable newspaper in the United States mail. The corporation demurred to the indictment on the ground that it could not, knowingly deposit and well know the contents of an obscene newspaper. The court overruled the demurrer to the indictment and said that it was enough that the directors in their official capacity were, or ought to have been, aware of the insertion in the newspaper of improper and obnoxious matter. Judge Hough said in this case: "To fasten this species of knowledge upon a corporation requires no other or different kind of legal inference than has long been used to justify punitive damages in cases of tort against an incorporated defendant. If a corporation can corporately know that an engineer is an habitual drunkard, it can even more surely know the ordinary contents of a newspaper, the publication of which is its sole reason for existence.[25] In general, the modern tendency is to hold corporations for all crimes committed by them, whether arising from nonfeasance or misfeasance, and whether involving a malicious intent or not. In fact, there seems to be no good reason why corporations cannot be held liable for any and every criminal offense,

[24] United States v. MacAndrews & Forbes Co., 149 Fed. 823.
[25] United States v. N. Y. Herald Co., 159 Fed. 296.

even for such felonies as murder, except for the circumstance that the criminal law, as a general rule, does not provide for penalties and punishments applicable to corporations. There is a pronounced weight of authority holding them liable for all such crimes as may be punished by fines. What is needed is an amendment of our system of criminal procedure so as to provide for what is now lacking, namely, an adequate punishment for a corporation whose duly accredited agents or officers are guilty of a felony while engaged on its business and in its behalf. In a recent New York case,[26] the Court of Appeals stated that "a definition of certain forms of manslaughter might be formulated which would be applicable to a corporation." The court held, however, that under § 179, of the Penal Code of New York, which defines homicide as "the killing of one human being by the act, procurement or omission of another," a corporation could not be guilty, since by "another" is meant another human being. On the other hand, in a recent federal case,[27] a corporation was held guilty of manslaughter, resulting from the lack of life-preservers on one of its steamboats. Similarly, corporations have been held liable for criminal libel.[28]

144. **Same subject—Practical illustrations.**—One further illustration will suffice. Suppose the directors of a corporation which is being prosecuted by the federal government duly determine that it is for the

[26] People v. Rochester Ry. & Light Co., 195 N. Y. 102, 88 N. E. 22.
[27] United States v. Van Schaick, 134 Fed. 592.
[28] State v. Atchison, 3 Lea 729 (Tenn.), LEADING ILLUSTRATIVE CASES.

best interests of the corporation to have a certain prosecuting officer murdered, or at least disabled. They, accordingly, hold a stockholders' meeting and the stockholders approve this determination of the directors. A "gunman" is hired with instructions to do the job neatly and with dispatch. The prosecuting officer, accordingly, is murdered. The corporation is indicted for murder. Is there any logical reason why it should not be held? There can be no question of want of authority for not only the directors but the stockholders as well authorized the employment of the gunman. Besides, the act was plainly done on the corporate behalf and supposedly with its interests in view. If there is no punishment for the corporation to fit the crime, then our codes of criminal procedure should be amended. The modern tendency is all in this direction.

145. **Modern tendency of the law.**—Corporations have been held liable in recent decisions for such offences as the following: taking salmon unlawfully; failure to supply drinking water on trains; unlawfully selling liquor to a minor; operating a disorderly resort; maintaining a criminal nuisance; violating the law forbidding employes to be worked more than eight hours a day; committing a criminal contempt; usury; improper advertising to practice medicine; and many kindred offenses in many of which an essential ingredient of the crime consisted in the possession of a wicked and malicious intent. A corporation, we may safely say today, may be held liable criminally even for offenses of which a specific criminal intent is an essential element.

CHAPTER X

DIRECTORS—HEREIN ALSO OF OFFICERS AND AGENTS.

146. **Directors defined.**—The directors of a corporation are the general managers of the ordinary and usual business of the corporation. They are selected by the stockholders, but they are more than the mere agents of the stockholders, since they have the power, provided they act in good faith, to adopt a course of action which may not be in accord with the wishes of the stockholders. Therefore, it is incorrect to say that directors are merely the agents of the corporation and its stockholders. They are that, but they are also a good deal more, as will be seen. Another view of the directors regards them as trustees. This is not sound. In many respects the duties of a corporate director are similar to those of a trustee. For example, the director owes to the corporation and its stockholders the duty of the utmost good faith. However, there is no separation of the property into legal and equitable estates. The legal title to the corporate property is not vested in the directors. Therefore, it is incorrect to talk of the directors as trustees and of the stockholders as cestuis que trust (beneficiaries). If a true trust existed, the equitable estate would be in the stockholders and the legal estate in the directors. This, however, is not the case. The interest of the stockholders is decidedly more than a mere equitable interest. And

the trustees have not the legal title to the corporate property. The legal title is in the corporate entity, the artificial personality. Sometimes corporate directors have been regarded as bailees or mandatories. This is an unsatisfactory classification. In a bailment, the legal possession of the property is vested in the bailee or mandatory. He has a special property interest. On the other hand, the director is not vested with any special property in the corporate possessions. The director resembles the agent, the trustee, and the bailee or mandatory. However, the director is not exactly analogous to any of these. In a well-known New York case,[29] Judge Van Brunt regarded the directors of a corporation as similar to, although by no means identical with, agents of a principal. The board of directors of a corporation, however, do not stand in the same relation to the corporate body which a private agent holds towards his principal. All the authority of a private agent is derived by delegation from his principal. In corporate bodies, however, the powers of the directors are, in a very important sense, original and undelegated.[30] The position of corporate directors is really *sui generis* (unique and characteristic).

147. **Relation between corporation and its directors.**—The board of directors of a private corporation are not only the quasi-agents of the corporation, but, when convened as a board, are the primary possessors of all the powers which the charter confers

[29] Metropolitan Elevated R. Co. v. Manhattan Elevated R. Co., 11 Daly 373 (N. Y.), LEADING ILLUSTRATIVE CASES.

[30] Hoyt v. Thompson's Excr., 19 N. Y. 207.

upon directors. They are entrusted with the guidance of the business of the company, and the stockholders cannot interfere with them so long as the directors are acting within the scope of their authority. The peculiar relation which the directors bear to a corporation and the owners of its stock grows out of the inability of the corporation to act except through managing officers and agents. The corporation is the owner of the corporate property, but the directors, in the performance of their duty, possess this property and may act in every way as if they owned it. The stockholders cannot act in relation to the ordinary business of the corporation, nor can they properly control the directors in the exercise of the judgment vested in them by virtue of their office. The courts, however, are by no means unanimous, and there are many decisions to the effect that the will of the stockholders, who are, after all, the real parties in interest, must prevail. But it would be somewhat startling to the business community if it were true that the directors of a corporation were mere employees and that, as a result, the stockholders could control or remove them at any time.[31]

148. **Powers.**—The directors control all the ordinary and usual business affairs of the corporation. It is often a close question as to what is within the scope of the ordinary business transactions of a corporation. Suppose the corporation wishes to increase the amount of its capital stock. May the directors do this? The answer of the United States

[31] People ex rel. Manice v. Powell, 201 N. Y. 194, 94 N. E. 634.

Supreme Court was in the negative.[32] The court said, speaking through Justice Bradley: "The general power to perform all corporate acts does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock. Changes in the purpose and object of an association or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character, and cannot, on general principles, be made without the express or implied consent of the members." The test always is, whether the act sought to be performed is within the scope of the ordinary corporate business. Questions of vital importance, such as the restoration of lost capital, are matters for the stockholders to pass upon. It would be going far beyond the usual powers conferred upon directors to permit them to perform extraordinary and fundamental acts. It has been held that the directors possess authority to execute a lease of corporate property, although in Pennsylvania such an act is not regarded as in the management of the ordinary affairs of a company. Directors may make an assignment for the general benefit of creditors. They may enter into contracts, select inferior officers, fix their salary, control the performance of their duties, execute mortgages, and even compromise doubtful claims. However, directors have no authority to increase or decrease the amount of capital stock, to admit corporate willingness to be adjudged bankrupt, to release a stock subscription,

[32] Chicago City R. Co. v. Allerton, 18 Wall. 233 (U. S.), LEADING ILLUSTRATIVE CASES.

to accept a vital amendment to the charter of the corporation, or to change the nature or scope of the corporate enterprise. These latter are all regarded as extraordinary acts. Even in jurisdictions where directors are held to have the power to perform them, a wise board of directors will not do so without first consulting the shareholders and, if possible, calling a stockholders' meeting.

149. **Same subject—Stockholders' control.**—Within the scope of their authority—that is, in regulating the ordinary business affairs of the corporation—the power of the directors is supreme, and the stockholders have no right to dictate to them or to order them to do or not to do certain acts. On principle, this is sound; but, as has been seen, the authorities are not in entire harmony. In jurisdictions which take the view that the directors are merely the agents of the stockholders and nothing more, the directors are regarded as subject to the control of the majority stockholders. In a recent English case, the majority of the stockholders desired that a certain contract be entered into. The directors refused to do so, believing that the best interests of the company demanded a different disposition of the matter. The court held that the directors were not bound to comply with the wishes of the majority, and that as to matters whose control is vested in them, they are supreme. In the Court of Appeals, Lord Justice Cozens-Hardy said: "I do not think it true to say that the directors are agents. I think it is more nearly true to say that they are in the position of managing partners, appointed to fill that post by

a mutual arrangement between all the shareholders." In the lower court, Judge Warrington had pointed out the absurd consequences which would follow if a mere majority of the shareholders were permitted to supervise the directors. He said: "It seems to me that if a majority of the shareholders can, on a matter which is vested in the directors, overrule the discretion of the directors, there might just as well be no provision at all in the articles as to the removal of the directors by special resolution. Moreover, pressed to its logical conclusion, the result would be that when a majority of the shareholders disagree with the policy of the directors, though they cannot remove the directors except by special resolution, they might carry on the whole of the business of the company as they please, and thus, though not able to remove the directors, overrule every act which the board might otherwise do." This seems the better view, but many American cases hold that in stock corporations, the ultimate and absolute power and control is vested in the shareholders.

150. **Meetings.**—The authority of the directors is vested in them only when duly convened *as a board*. Thus, where the stockholders, including the directors, met and passed upon a matter which was in the control of the directors, it was held that the action taken was invalid. The directors must be duly assembled as a board of directors.[33] Suppose the board of aldermen of a town was vested with the authority to perform a certain act. Would an ordinance passed by the citizens of the town, assembled in public meet-

[33] Gashwiler v. Willis, 33 Cal. 11.

ing, and including the aldermen, be valid? The question answers itself. That is not the mode in which the corporation, whether private or municipal, is authorized by the law of its creation to manifest its will and exercise its corporate powers. In an early New York case,[84] a lease of the iron works of a corporation was made in pursuance of a resolution adopted at a meeting of the stockholders, at which the directors were present. It was held that the resolution imparted no authority to make the lease. The court said: "The stockholders in this case had no power to make a lease or do any other administrative act in the management of the affairs of the corporation. If a lease could be made at all, it could be executed only in pursuance of the act of the directors, who are the body appointed by the charter for the management of its affairs. It is no answer that the individual stockholders, who were present at the meeting when the lease was ordered, were also directors. They did not meet as directors, but as stockholders. The mayor and common council of a municipal corporation can only act in the manner prescribed by law. When not acting in their official character and in the mode prescribed by law, their acts are no more binding than those of other private citizens." The board of directors must, moreover, be legally assembled. Where the statute requires that their meetings be held within the state, this must be done or their acts will be invalid. The directors must, if possible, attend the meetings. They cannot delegate their right to attend to anyone else.

[84] Conro v. Port Henry Iron Co., 12 Barb. 27 (N. Y.).

151. **Delegation of authority.**—As a general rule, a board of directors has no right to delegate their authority to others. The stockholders elected them individually as directors, and presumably relied on their individual efficiency, integrity, and capacity. For example, the board of directors of a corporation are vested with the power to declare dividends. This manifestly involves the exercise of a great amount of judgment and discretion. Should a surplus be distributed in the form of dividends to the stockholders, or should it be accumulated against a rainy day? This, and similar questions, involve the exercise of personal judgment, and manifestly the directors cannot delegate the disposition of such matters to other persons. On the other hand, the directors may delegate their purely ministerial duties. For example, the directors are not required personally to draw up a corporate conveyance. They may authorize an agent or attorney to do it. Suppose that a board of directors wishes to delegate its powers to an executive committee consisting of three or five of the directors. Can it do so? The courts usually hold that this may lawfully be done. The New York Court of Appeals has held that directors, in the absence of statute, may invest an executive committee "with power to transact the business of the company during the intervals between the meetings of the board of trustees."[35] Sometimes the board of trustees or board of directors practically abrogates its powers by committing all of the corporate powers to a super-

[35] Sheridan Elec. Light Co. v. Chatham Nat. Bk., 127 N. Y. 517, 28 N. E. 467.

intendent or general manager. Where this is done, and the board abdicates its authority in this manner, the corporation will be bound by the act of the officer although the act performed is one which is vested in the board of directors. The trend of authority is in the direction of holding that where an officer or agent is entrusted with the performance of the entire functions of the corporation, and this has become a settled policy, the act of the officer, acquiesced in by all the directors and stockholders, will be held binding. Thus, a corporation has been bound by such an act of its officer in executing a mortgage.[36]

In the recent federal case, Cunningham v. German Insurance Bank,[37] Judge Severens said: "The proof was ample to show that the corporation of Scanlan & Co. practically devolved the powers of the board of directors upon its executive officers, and that this method of doing business was not casual and temporary merely, but continuous from the date of its commencing to do business to the end. The board of directors was dormant. The rule is that where, by the direction or acquiescence of the stockholders, the executive officers of a corporation assume and exercise the functions of the board of directors, the corporation and those deriving rights from it while it is so managing its affairs are bound by the acts of its officers to the same extent as if they had been directed by the board. In so far as the duties of the directors are not expressly prescribed by the charter, they derive their powers from the stockholders, who may, if they see fit, select

[36] Garmany v. Lawton, 124 Ga. 876, 53 S. E. 669.

[37] 101 Fed. 977, 11 C. C. A. 609.

other agencies for the transaction of the corporate business."

152. **Removal.**—The directors of a corporation may be removed by the court for misconduct. But the shareholders have no authority to remove them during their term of office simply because a difference of opinion exists between the stockholders and directors. The stockholders may, however, amend the by-laws so as to increase the number of directors. In an English case, it was held that, under the English Companies' Act, a general meeting of the shareholders of a corporation was vested with authority and power to remove the corporate directors. This was the result of the English statute. If it was not, the result reached would be unsound and would overlook the distinction between a person occupying an ordinary contract relation as an agent for a principal, on the one hand, and a person elected for a specified term of office as a director in a private corporation, on the other hand.

In many jurisdictions, including the state of New York, it is provided by statute that an action may be maintained against a director of a corporation to procure a judgment suspending him from the exercise of his office, if it be made to appear that he has abused his trust; or to remove him from office upon proof of positive misconduct. It is generally also provided that a director shall not be suspended or removed from office otherwise than by the final judgment of a competent court. Without some statute or some provision contained in the corporate charter authorizing the removal or suspension of a director,

a director cannot be removed or suspended from office until the end of his term, at least without cause.[38]

If a director is unlawfully removed from office, he is entitled to be reinstated. The remedy is an action in the nature of a quo warranto to test the title to the office of director. The remedy is not mandamus.

153. **Compensation.**—The directors of a corporation are supposed to act without compensation. The theory of the law is that the honor and distinction of the position is a sufficient reward. "No person is under the slightest compulsion to accept the position, and if he is unwilling to do so without compensation, public policy requires that his compensation should be fixed and certain before he enters upon the discharge of the duties of his office. This rule must apply to services rendered by persons holding the office of directors, who have the control of the funds of the body. But a person, not a director and having no control over the funds and property of the corporation, rendering services, does not occupy the relation of trustee to the company, and does not fall within the rule, and may recover a reasonable compensation for services rendered. The law has never conferred on trustees the authority to profit by the exercise of the powers and duties of their position."[39]

The law, in other words, regards the director as a trustee, at least in this respect. It was a well settled rule of the common law that a trustee was not

[38] People ex rel. Manice v. Powell, 201 N. Y. 194, 94 N. E. 634.
[39] Cheeney v. Lafayette, etc., R. Co., 68 Ill. 570.

entitled to compensation and could not recover even the reasonable value of his services. The law does not require a company to pay directly or indirectly for the services of directors, since they are regarded as standing in a fiduciary relation to the corporation. In an early Connecticut case, the court says: "It would be a sad spectacle to see the managers of any corporation assembling together and parceling out among themselves the obligations and other property of the corporation in payment for past services."[40]

Directors may, however, recover for the performance of duties performed by them outside of those devolving on them as directors. For example, let us suppose that a director, who is also a noted architect, draws up a set of plans for the corporation. It is but reasonable and just that he should be allowed to recover a fair compensation for such services, even in the absence of an express precedent promise to pay him for them. Such services are extraordinary, not included in the ordinary functions of the office of director, and an implied promise to pay for them arises. The same result follows where a director of a corporation is employed as attorney for the corporation. The question always is, whether the duties are performed by the director in his capacity and as a part of his duty as a director, or whether he is performing them as a special agent of the company, and is acting outside of his duties as a corporate director. It has been held in Wisconsin that the rule as to compensation of directors also applies to the president, treasurer, and other principal officers

[40] N. Y. & N. H. R. R. v. Ketcham, 27 Conn. 175.

of a private corporation who are also stockholders or directors. The general rule is, then, that a director is not ordinarily entitled to compensation, but that when he performs duties outside of those imposed upon him as a director, he is entitled to recover, just as though he was not a director. This rule was applied in Indiana, where a director sued his corporation to recover for services rendered and materials furnished in order to finish a turnpike owned by the corporation and put the road into a condition fit for use.[41] In this connection it should also be noted that directors are entitled to indemnity from their corporation against all losses and expenses properly incurred by them in the due performance of the duties of their office. In a sense, the corporation is their cestui que trust (beneficiary of a trust) and is bound, therefore, to indemnify the directors, just as the beneficiary of a trust estate is equitably bound to indemnify the trustee thereof.[42]

154. **Liability for unauthorized or illegal acts.**—The directors of a corporation owe to it certain well-defined duties. These are chiefly the duty of obedience, the duty of diligence, and the duty of loyalty. First and foremost is the duty of obedience. This means that the directors must keep within the scope of their chartered powers. They are liable to the corporation for all ultra vires acts performed by them. The shareholders may resort to injunction proceedings to enjoin the performance of such acts where they have not yet been performed. Where

[41] Greensboro, etc., Turnpike Co. v. Stratton, 120 Ind. 294, 22 N. E. 247.

[42] In re National Financial Co., L. R. 3 Chan. App. Cas. 791 (Eng.); Young v. Naval Society, Limited, (1905) 1 K. B. 687 (Eng.).

they have already been carried out, the remedy of the stockholders is to hold the directors liable in equity and compel them to account, or to seek a rescission. Just as an agent must keep within the scope of the authority vested in him by his principal, so the directors of a corporation must keep within the scope of the authority vested in them. Thus, dividends may not be paid out of capital, and directors are personally liable if they are disobedient or negligent and pay dividends out of the capital stock.

155. **Same subject—Effect of good faith.**—Suppose that the directors have acted in good faith and with as much care and discretion as a man of ordinary prudence would use in his own affairs, and that despite this they have fallen into a mistake in regard to their powers. Are they liable for such an innocent mistake or error? In a leading Rhode Island case,[48] it was held that the law requires of them only a reasonable degree of care and discretion, and that if the directors practiced this, they are not answerable for a mere honest mistake. We have already seen the difficulty, in many cases, of determining whether a certain act is within or without the corporate powers. It would be unfair in many cases to hold directors liable where though acting in perfect good faith they have chanced to exceed the extent of the corporate authority. On the other hand, the English cases adopt a stricter rule. They hold that if directors exceed the limit of their authority, they should be held liable for all loss occasioned by their improper and unauthorized conduct. In a

[48] Hodges v. New England Screw Co., 1 R. I. 312.

well-known English case,[44] the directors, acting in good faith, divided part of the corporate capital among the shareholders. This, of course, was ultra vires. The question arose whether the directors were liable to account. The Master of the Rolls, Lord Jessel, said: "Ought I to make them account? I think I ought. As to saying they did it bona fide, I think it is impossible to come to that conclusion; a man may not intend to commit a fraud, or may not intend to do anything which casuists might call immoral, and he may be told that to misapply money is the right thing to do; but when he has the facts before him—when the plain and patent facts are brought to his knowledge—as I have often said, and I say now again, I will not dive into the recesses of his mind to say whether he believed, when he was doing a dishonest act, that he was doing an honest one. I cannot allow that man to come forward and say, 'I did not know I was doing wrong when I put my hand into my neighbor's pocket and took so much money out and put it into my own.' It is impossible in a court of justice to call a particular act a bona fide act simply because a man says that he did not intend to commit a fraud."

A striking illustration of this question is found in the recent case of People ex rel. Perkins v. Moss.[45] Mr. George W. Perkins, a vice-president and director of the New York Life Insurance Co., contributed the sum of fifty thousand dollars out of its corporate funds to the presidential campaign fund of the Republican

[44] In re National Funds Assur. Co., L. R. 10 Chan. Div. 118 (Eng.).
[45] 187 N. Y. 410, 80 N. E. 383.

National Committee. This act was obviously ultra vires. By a vote of four to three, the Court of Appeals of New York decided that Mr. Perkins was not guilty of grand larceny; that is, he was not guilty of criminal liability. But the judges intimated, in strong dicta, that Mr. Perkins was civilly liable in spite of the fact that he had acted in the honest belief that he had benefited the company and had concededly derived no personal advantage. Even the majority judges said that a mistake had been made which would not relieve from liability in a civil suit. Suppose the directors of a manufacturing corporation contributed from its funds toward the erection of a church. This is probably such an unauthorized use of the funds of the corporation as would make the officers civilly liable, but it can hardly be said that they could properly be prosecuted criminally for larceny.

156. **Duty of diligence.**—The second great duty owed by the directors to the corporation is the duty of diligence. They owe the duty to exercise ordinary care and diligence and to use a reasonable degree of business judgment and prudence in the management of the affairs of the corporation. For failure in this respect, they may be held personally liable by the corporation in a suit for damages. There is a serious conflict in the authorities as to the extent of the duty of diligence owed by the corporate directors. The Pennsylvania cases insist that the director is only liable if he is guilty of fraud or wilful misconduct, and hold the directors are not liable for mistakes of judgment, "even though they may be so gross

as to appear to us absurd and ridiculous."[46] These cases represent one extreme. On the other hand, the Tennessee cases hold that directors must exercise the same degree of care and diligence that they would use in their own affairs or in the conduct of their own private business.[47] In one Tennessee case, the court, speaking of certain careless acts of directors, said: "No prudent man would have done with his own money as these directors have in this case." The true test would seem to be that the director owes to a corporation that degree of reasonable business knowledge and skill and that amount of care and diligence which a person in the position of director of that particular corporation would be expected to give, under the circumstances of the particular case. For example, the director of an ordinary trading corporation is not held to the same degree of care as the director of a national bank, and the director of the national bank, in turn, might not be held liable to the same degree of caution and prudence as the director of a savings institution where poor persons deposit. The idea is not to be derived that directors serve merely as gilded ornaments of the corporation. They must not lend their names simply as lures, or for advertising purposes. They must actually participate in the management of the company, and if they are guilty of culpable negligence, they should be held liable even though they have not profited personally, or acted fraudulently. But often, nowadays, promi-

[46] Spering's Appeal, 71 Pa. St. 11, per Sharswood, J.

[47] Shea v. Mabry, 1 Lea 319 (Tenn.); Vance v. Phoenix Insurance Co., 4 Lea 385 (Tenn.).

nent individuals simply lend their names to corporations and fail to perform any of the functions or duties which devolve upon directors. This is absolutely improper. The courts are seeking to discourage this kind of conduct by holding directors to a strict degree of personal responsibility for lack of prudence, caution, and of careful diligence.

As to what constitutes the amount and measure of diligence, it is impossible to lay down any arbitrary rule. The degree of care required depends largely upon the subjects to which it is to be applied. "What would be slight neglect in the care of a quantity of iron might be gross neglect in the care of a jewel. What would be slight neglect in the care exercised in the affairs of a turnpike corporation, or even of a manufacturing corporation, might be gross neglect in the care exercised in the management of a savings bank entrusted with the savings of a multitude of poor people depending for its life upon credit and liable to be wrecked by the breath of suspicion." The only general rule which can be formulated is that directors must exercise that amount of ordinary care and prudence which a reasonable individual would use under the circumstances in the office of director of the corporation in question.[48]

157. **Same subject—Gross neglect.**—In a few cases it has been insisted that the directors of a corporation are only responsible for gross inattention and negligence. The theory of these decisions is that ordinarily directors act without compensation, and

[48] Briggs v. Spaulding, 141 U. S. 132, 35 L. Ed. 662; Gibbons v. Anderson, 80 Fed. 345, LEADING ILLUSTRATIVE CASES.

that therefore they should not be held to too strict a degree of diligence. This rule amounts to saying that the directors only owe a slight degree of care in the performance of their duties. This proposition is, of course, monstrous. To hold that directors, entrusted with the management of the property, interests, and business of the shareholders, who divested themselves of the management of the company and confided in them, owe only slight care to the duties of their trust, is a proposition which refutes itself. As said by Judge Earl in a leading New York case:[49] "It is true that authorities are found which hold that trustees are liable only for *crassa negligentia,* which, literally, means gross negligence; but that phrase has been defined to mean absence of ordinary care and intelligence applicable to the particular case." The argument has also sometimes been advanced that gentlemen will not act as directors if too strict a rule is applied. The answer to this is that it is not too strict a rule to require directors to use ordinary care in attending to the duties conferred upon them.

A director is not required personally to supervise each and every act of the inferior officers of his corporation. This would of course be an impossibility. But he is required to exercise an ordinary and reasonable degree of supervision. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management. On the other hand, too much trust must not be confided,

[49] Hun v. Cary, 82 N. Y. 65, 37 Am. Rep. 546.

and a periodic review of the conditions of the corporate business is requisite. A degree of care commensurate with the evils sought to be avoided is necessary. A want of that care certainly makes directors personally responsible. As said by Justice Harlan in the famous case of Briggs v. Spaulding: "As to the degree of diligence and the extent of supervision to be exercised by directors, there can be no room for doubt under the authorities. It is such diligence and supervision as the situation and the nature of the business requires. Their duty is to watch over and guard the interests committed to them. In fidelity to their oaths, and to the obligations they assume, they must do all that reasonably prudent and careful men ought to do for the protection of the interests of others intrusted to their charge."

158. **Same subject—Practical illustrations.**—Suppose that the directors of a savings bank enter upon an elaborate advertising campaign, construct a new and magnificent building, and purchase expensive ornamental furnishings and fixtures, believing that this will bring them more deposits. Assume that they are acting honestly and for what they believe is the welfare of the institution. Assume further that the bank at the time of these operations was already none too strong and was sure to be greatly weakened thereby. Insolvency ensued. The receiver of the bank sued the directors personally to recover the losses by their alleged misconduct. Under this state of facts, the New York Court of Appeals held the directors liable, saying that their duty was to safeguard the accounts of the old depositors before seek-

ing to obtain new accounts. The court declared that the directors had acted as no ordinary business man of reasonable intelligence and prudence would have acted under the circumstances of the case. Notice that the directors acted honestly. Notice further that they made no personal profit out of the transaction. The directors were held responsible for the reason that their stupidity and unsoundness were inexcusable. They failed to exhibit that degree of ordinary human intelligence which one has a reasonable right to expect in corporate directors.

Suppose that the directors of a national bank have year after year failed to exercise any supervision over its officers and agents. As a result, frauds are committed which the most superficial examination would have promptly revealed. Under these circumstances, the case would be one of supine, continuous negligence, and the directors would be liable in the event of a loss. The question is one of compound fact and law under the circumstances of each individual case. No comprehensive rule which will govern all cases can be laid down. It must be remembered, however, that directors owe more than a mere duty of good faith. They also owe the absolute duty of using that amount of intelligence and diligence which an ordinary human being would be expected to exhibit under all the facts and circumstances.

159. **Dealings of directors with their corporations.**—The directors of a corporation stand in a fiduciary relation to the corporation and its stockholders. They are not trustees in the technical sense of the term, and yet they stand in a position very

similar to that of trustees. A director of a corporation, like a trustee, is bound to act in the utmost good faith and is forbidden to take part in any transaction in which he has an interest adverse to that of the corporation. As we shall see, the director is not absolutely prohibited from dealing directly with the corporation of which he is a director; but if he does engage in such dealings, he must act in the utmost good faith and must refrain from doing anything unfair or treacherous. In fact, it might be said that the third great duty which the directors owe to the corporation is the duty of loyalty. The director should always remember that he owes a duty of the utmost good faith toward the corporation and toward the shareholders who elected him. In many cases, the personal interest of the director may conflict with his duty to the corporation. Where this is the case, the director must always submerge his personal interest, and should bear in mind the rule, as true today as it was in Biblical times, that a man cannot serve two masters.

In the early days of the common law, directors were regarded as absolutely incapacitated from dealing with their corporation. In a leading decision of the House of Lords,[50] suit was brought by the director of a railway corporation against the company to recover the agreed purchase price of certain iron chairs which he had sold to the company. The principal defense was that at the time of the contract plaintiff was a director, and indeed chairman, of

[50] Aberdeen Railway Co. v. Blakie Bros., 1 Macq. H. L. 461 (Eng.).

the railway company, and was incapacitated from dealing with his own corporation. The court decided that the contract was void, without regard to its fairness or unfairness. The Lord Chancellor said: "The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into."

Few American cases go to this extreme extent, but the general American rule regards such contracts as only voidable. If the director has acted in good faith, and if the contract is fair and reasonable, and if no undue advantage was taken of the corporation, such contracts are generally upheld.

160. **Same subject—Duty of good faith.**—The ultimate test of the validity of contracts between a corporation and its directors would seem to be whether the director has acted in good faith, and whether the contract itself is fair and just. If these two questions are answered in the affirmative, there

seems no reason for regarding the contract as a nullity. Suppose a corporation needs money and its directors are the only ones willing to lend. Under these circumstances it would be unfair and unjust to declare that the directors cannot recover the amount of their loan from the corporation. It would be penalizing the director, who, in nine cases out of ten, is the only person likely to be willing to make such a loan.

The director, however, must not take part in the votes in the meeting of the board of directors where his contract is passed upon. In a leading Massachusetts case,[51] a director entered into a contract with his corporation, whereby he was to be allowed a certain percentage on all corporate claims which he could collect. The contract was held valid, and the court laid especial stress upon the circumstance that the director took no part in the vote. Chief Justice Holmes said: "In this country it very generally has been deemed impracticable to adopt a rule which absolutely prohibits such contracts. Whatever small conflict of interest between himself and the company there may have been, was no greater or other than that between a broker paid by a percentage and his principal." A few jurisdictions are still more liberal. In California and Illinois, for example, the contract is not vitiated because the interested director was present at the meeting and voted, provided that without his vote there was a disinterested majority.[52]

[51] Ft. Payne Rolling Mill v. Hill, 174 Mass. 224, 54 N. E. 532.

[52] Schnittger v. Old Home Con. Min. Co., 144 Cal. 603, 78 Pac. 9; Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362.

However, a director's contract in these states is voidable without regard to good faith or fairness if there is no disinterested majority. The law also is, that where a salary or compensation is paid to the officer or director, the resolution is illegal if it is carried by his vote or produced by his influence.

On the other hand, in several jurisdictions, including New Jersey, the director is regarded as under a duty to vote. As said by Judge Dixon in Stewart v. Lehigh Valley R. Co.:[53] "Nor is it proper for one of a board of directors to support his contract with his company, upon the ground that he abstained from participating as director in the negotiations for and final adoption of the bargains by his co-directors; the very words in which he asserts his right declare his wrong; he ought to have participated, and in the interest of the stockholders, and if he did not, and they have thereby suffered loss, of which they shall be the judges, he must restore the rights he has obtained—he must hold against them no advantage that he has got through neglect of his duty toward them."

Many authorities on corporation law feel that it would have been wiser for the common law to adhere to the early doctrine that a director is under a complete disability to deal with his corporation. This, however, seems extreme and unreasonable and overlooks the circumstance that such a doctrine, while it would afford apparently little protection to the corporation against actual fraud or oppression, would deprive it of the aid of those most interested in giving

[53] 38 N. J. Law 505.

it judiciously and most qualified to judge of the necessity of that aid and of the extent to which it may safely be given. In a leading United States Supreme Court decision,[54] it was held that a director could lend money to his corporation when it became embarrassed, taking in return its promissory note secured by a deed of trust of the corporate property, and that on default he could foreclose and buy in the security in order to prevent loss to himself. It appeared that the director had loaned the money in good faith and in order, honestly, to assist it in its difficulties. When his money became due, the property was sold by the trustee, and the director bought it in at a fair and open sale, and at a reasonable price. There was no actual fraud or oppression, and no advantage was taken by the director of his official position. It was contended that the purchase was absolutely void, but the Supreme Court, rejecting this proposition, said: "While it is true that the defendant, as the director of the corporation, was bound by all those rules of conscientious fairness which courts of equity have imposed as the guides for dealing in such cases, it cannot be maintained that any rule forbids one director among several from lending money to the corporation when money is needed and the transaction is open, and otherwise free from blame." If a director may loan money in good faith to his corporation, and take its bond secured by mortgage, it necessarily seems to follow that, like any other mortgagee, he may protect himself even to the extent of becoming a purchaser at a foreclosure sale.

[54] Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, 23 L. Ed. 328.

This rule is not, however, universal, and several decisions deny the right.

161. **Same subject—Secret profits.**—The director of a corporation is forbidden to enter into an agreement whereby he may derive a secret profit, or unfair profit, at the expense of his corporation. In an early Massachusetts case,[55] the directors of a corporation purchased a steamboat in their individual capacities. Subsequently, while acting on behalf of the corporation in their official capacities as corporate directors, they purchased this vessel from themselves, as individuals, at a very considerable advance in price. It was held that the transaction was invalid and that the directors were bound to account to the receivers of the corporation for "all the profits thus made." In a very recent case decided by the Appellate Division of the Supreme Court of New York,[56] P, a director of a corporation, was promised $500 by D, if P would procure for D a contract for certain building work from his corporation. D obtained the contract and received the stipulated payment. P demanded the $500 promised to him and was met with a refusal. The court held unanimously that P could not recover, that the contract was illegal and void as against public policy, and that his complaint must be dismissed. It was held immaterial that P had told the majority of his co-directors about his arrangement with D. This decision is sound. P, holding the office of director of the corporation, occupied a fiduciary relation to it and was a quasi trustee for it and

[55] Parker v. Nickerson, 112 Mass. 195.

[56] Landes v. Hart, 131 App. Div. 6 (N. Y.), 115 N. Y. Supp. 337.

its stockholders. As such trustee, it was his duty to obtain as low a price as he was able from D for the doing of the contemplated work. If D could afford to pay to P $500 from the amount which D was to receive from the corporation for the work, it stands to reason that D could have afforded to make a contract to do it for $500 less than the stipulated price. And it was P's plain duty as a director to obtain for his corporation the contract at such reduced amount. Such arrangements are invalid and void because they tend to induce a director to violate his duty towards his corporation and to betray the confidence and trust reposed in him. Such contracts are not made valid by the circumstance that the actions of the unfaithful director may have, in fact, resulted in benefit to his corporation. Nor are they validated by the fact that the unfaithful director may have informed his fellow directors of his corrupt bargain. It might be noted that this general proposition applies not only to directors but also to the corporate officers.

162. **Contracts between corporations with interlocking directors.**—In an early New York case, it was held that the contract entered into between two corporations, some of whose directors held office in each corporation, was invalid and void.[57] The reasons assigned were the temptations to a breach of trust because of the existence of divided allegiance. Very few modern cases go to this extreme, however. The same rule is generally applied to contracts made

[57] Metropolitan Elev. R. Co. v. Manhattan Elev. R. Co., 11 Daly 373 (N. Y.).

between corporations with interlocking directors as is applied to contracts entered into between a director and his corporation. The test is one of fairness and good faith. As said by Judge McFarland in a leading California decision:[58] "Where two corporations, through their boards of directors, make a contract with each other, the directors who are common to both are not within the rigid rule of the cases which hold that one who acts in a fiduciary capacity cannot deal with himself in his individual capacity, and that any contract thus made will be declared void without any examination into its fairness, or the benefits derived from it to the cestui que trust. Two corporations have the right, within the scope of their chartered powers, to deal with each other; and this right is certainly not destroyed or paralyzed by the fact that some, or a majority, of the directors are common to both. Of course, if such directors should wrongfully and wilfully use their powers to the prejudice of one of the corporations, their action, if not acquiesced in, and if contested at the proper time, could be avoided, as in any other case of actual fraud. But such common directors owe the same fidelity to both corporations, and there is no presumption that they will deal unfairly with either; therefore, their acts as such common directors are not void."

Corporations are certainly competent to contract with each other. Their mutual directors are presumably interested in both companies, owe duties to each, and are bound to be faithful alike to each. Therefore, while acting within the scope of the

[58] San Diego, etc., R. Co. v. Pacific Beach Co., 112 Cal. 53, 44 Pac. 333.

powers delegated to them by the stockholders of each corporation, there exists no presumption of illegality or unfairness in their dealings or contracts as between the two companies. They are the chosen agents of both corporations. To be successful in any attempt to impeach the validity of their acts, with the view of making them personally responsible either to the corporation or to the stockholders, distinct charges of misconduct, fully supported by adequate proof, should be required.[59] There exists a strong inclination today, in some jurisdictions, to regard transactions made by interlocking directors as invalid and void, or as voidable although fair. This, however, seems unsound on principle. The case is not identical at all with that of a trustee, agent or director, bargaining individually with the party reposing trust and confidence in him. Courts should not be influenced by public clamor to place serious and unreasonable obstacles in the corporate pathway.

163. **Duty toward the individual stockholder.**—The law is well settled that the director in a corporation stands in a fiduciary relation to the corporation, that is, to the entire body of stockholders considered as a collective unit. The weight of authority holds, however, that the director of a corporation does not stand in a fiduciary relation to the individual holder of stock. In a leading Indiana case,[60] a director of a corporation, who was also its president, bought the shares of stock of an individual shareholder. He paid the market value of the stock, so

[59] Booth v. Robinson, 55 Md. 419, 439-442.

[60] Board of Commissioners v. Reynolds, 44 Ind. 509.

far as the stock seemed to have had a market value; but what he paid was greatly below its real value, as he well knew. He was well acquainted with the condition of the corporate affairs and knew that the stock was a very good purchase. No actual fraud was established. The court held that the director was not a trustee for the individual stockholder and did not stand in a relation of trust and confidence to him. The reasoning of the opinion was to the effect that stock in a corporation held by an individual is his own private property, which he holds free from the dominion and the control of the directors. Accordingly, in the purchase of stock by a director from a stockholder, said the court in this case, "The relation of trustee and cestui que trust does not exist between them."

In the New York case of Carpenter v. Danforth,[61] D, who was one of the corporate directors, purchased of P one hundred and thirty-six shares of the corporate stock. The court held that the action to have the sale declared void and to restore to the plaintiff his original interest, would not lie. This kind of decision rests upon the proposition that there is no legal privity between the holders of shares of stock, in their individual capacity, on the one side, and the directors of the corporation, on the other. The cases in which the directors of a corporation are regarded as trustees for the stockholders are distinguished on the ground that they refer to the management, by the directors, of the property or business of the corporation itself. It was very recently held

[61] 52 Barb. 581 (N. Y.).

by the Supreme Court of Illinois,[62] that "officers of a corporation may purchase the stock of stockholders on the same terms and as freely as they might purchase of a stranger." Suppose the director has certain inside information affecting the value of the stock. It has been held that, in the absence of actual fraud, a purchase under these circumstances from a shareholder will not be set aside for the mere failure to disclose this information.[63]

164. **Same subject—Recent developments.**—Of recent years there is evidenced in the decisions a decided inclination to establish a more stringent rule. In fact, in at least two states, Georgia and Kansas, the courts insist that "no process of reasoning and no amount of argument can destroy the fact that the director is, in a most important and legitimate sense, trustee for the stockholder." Of course, the director is not a strict trustee, since he does not hold title to the shares and is not under an absolute prohibition from dealing with the stockholders. But it is insisted that he is, at least, a quasi-trustee.[64] Suppose that the director is in possession of certain information which his duty to the corporation compels him to keep secret; can he purchase the stock of a shareholder whom he knows does not possess this information? The answer of the Kansas and Georgia courts is in the negative. They say: "The very fact that he cannot disclose prevents him from dealing with one

[62] Bawden v. Taylor, 254 Ill. 464, 98 N. E. 941.

[63] Hooker v. Midland Steel Co., 215 Ill. 444, 74 N. E. 445; Percival v. Wright, (1902) 2 Ch. Div. 421 (Eng.).

[64] Oliver v. Oliver, 118 Ga. 362, 45 S. E. 232; Stewart v. Harris, 69 Kans. 498, 77 Pac. 277, 66 L. R. A. 261, 105 Am. St. Rep. 178.

who does not know, and to whom material information cannot be made known." Suppose the director is under no duty to keep the information secret. Under these circumstances, the Georgia and Kansas courts hold that if the director does not disclose the information which he possesses, and which in a certain sense is a quasi-asset of the company, the sale will be set aside. Any other position, it is insisted, would leave the stockholders at the mercy of the directors, and their helpless prey. A recent decision by the Supreme Court of the United States holds that a director, who was also the general manager of a corporation, owed an obligation of disclosure to a stockholder.[65]

165. **Functions of corporate officers.**—The chief officers of every corporation are the president, the vice-president, the secretary, and the treasurer or cashier. They are ordinarily elected by the shareholders or the directors, more generally by the latter than by the former. They are agents of the corporation. By virtue of its very nature, a corporation can only act through such officers or agents. It is bound by all acts done by such officers within the actual or apparent scope of the authority vested in them. The manner in which the corporate business is carried on, together with the objects and purposes of the corporate organization, indicate usually the extent of the power of each officer. For example, the cashier of a banking corporation ordinarily has no power to make representations as to the general financial standing or responsibility of a customer of

[65] Strong v. Repide, 213 U. S. 419, 53 L. Ed. 853.

the bank. However, the bank's business may have been carried on in such a manner as to invest him with authority to do this. The ordinary rules governing the scope of an agent's authority apply to the agents and officers of a corporation just as they do to the agents of a private principal.

The president, as president, presides over corporate meetings. Under the corporate charter or by-laws, or as the result of a course of conduct acquiesced in by the shareholders and directors, the president is generally given the power to bind the corporation in all ordinary business transactions. For example, he generally signs contracts and certificates of stock, and executes the corporate conveyances. The vice-president performs the duties of the president when that officer is absent or incapacitated. "When a contract is made in the name of the corporation by the president in the usual course of business, which the directors have the power to authorize and to make, or to ratify after it is made, the presumption is that the contract is binding on the corporation until it is shown that the same was not authorized or ratified."[66] The secretary of a corporation, as a general rule, keeps the corporate minutes, that is, the records of the corporate meetings, and is the custodian of the seal of the corporation. He affixes and attests this to all formal corporate documents. The secretary is frequently allowed to issue shares of stock and to act as agent for the registration and transfer of shares. The treasurer keeps the corporate funds and is

[66] Nat. State Bank v. Vigo Co. Nat. Bk., 141 Ind. 352, LEADING ILLUSTRATIVE CASES.

authorized to endorse checks for the corporation. In some states, including Massachusetts, the treasurer has implied power to make promissory notes and draw bills of exchange for the corporation; but the weight of authority is otherwise and declares that special authorization to do these acts is necessary. In dealing with the duties of corporate officers it should be remembered that the duties of the president of a corporation organized to sell dry goods may be very different from those of the president of a banking and trust company. The nature of the business usually determines the scope of the powers of the different officers.

166. **De facto officers and directors.**—A de facto officer or director is one who is performing the duties of the officer or director which he purports to be, but who has no legal right to occupy the position. For example, let us suppose that X honestly believes he has been elected the president of a corporation. In fact, however, not he, but Y, was really elected. Yet the courts hold, for reasons of public policy, that the corporation is bound by all acts performed by X while acting in his capacity as president of the company. This is done under an analogy to the rules of law governing de facto public officers.[67]

[67] In re George Ringler & Co., 204 N. Y. 30, 97 N. E. 593.

CHAPTER XI.

CORPORATE MEMBERSHIP—HEREIN ALSO OF CAPITAL STOCK AND SHARES OF STOCK.

167. **Necessity of members.**—It is necessary for every corporation to possess members. In a stock corporation, membership is acquired by the purchase of one or more of the shares of stock into which the total capital stock of the company is divided. In a non-stock corporation, membership is acquired by complying with the conditions as set forth in the corporate charter and by-laws.

168. **Acquisition of membership.**—In a non-stock corporation it is necessary to obtain the approval of the members of the corporation before one may exercise the rights of membership. An application for membership is usually first required, and then a vote is taken on the subject. Non-stock corporations are generally organized for other purposes than that of pecuniary profit. In their organization, the *dilectus personarum* (personal element) plays an important factor.

Suppose, for example, A, B, C, and D incorporate for the purpose of a country club. They reserve the right, in the non-stock corporation which they formed, to pass upon the qualifications of applicants for club membership. On the other hand, in the ordinary stock corporation, the personality of the purchaser of shares of stock is, as a rule, immaterial.

Attempts have been made, however, even in stock corporations, to prevent the acquisition of membership by a purchaser of shares until he has been elected and approved. In some jurisdictions, this is regarded as invalid.

169. **The one-man company.**—Suppose that all the shares of stock of a corporation come into the possession of one person. Does the corporation continue to exist? We have seen that the courts answer this in the affirmative, and hold that it has no effect upon the continuance of the corporate life. The owner of all the shares of stock in a corporation, for example, cannot maintain an action of conversion to recover the value of property unlawfully taken from the corporate entity. What is meant by the one-man company, however, is the corporation which, from the outset, is intended to have only one bona fide stockholder. In England, such one-man companies are regarded as valid corporations.[68] The theory is that since the form of the incorporation act was complied with, the court will not inquire into the genuineness of the corporate organization. Suppose that X wishes to incorporate, and uses M, N, O, and P as dummies in order to comply with the form of the statutes, giving to each of them enough stock to qualify, but with a definite understanding that he (X) is to be the beneficial owner of such shares. Very few courts have thus far gone to the extent of holding that such a corporation is not valid. On principle, however, a one-man company of this

[68] Salamon v. Salamon & Co., (1897) App. Cas. 22, reversing (1895) 2 Ch. Div. 323 (Eng.).

sort seems obnoxious to the spirit of the law, if not to its letter.

170. **Stockholders' meetings.**—The shareholders of a corporation, in so far as they have a right to control the action of the corporation, must act at a stockholders' meeting, which has been duly convened and assembled. This meeting must be called by the proper corporate officer. The president or secretary is generally vested with the authority to do this; but in the absence of a provision to this effect in the corporate articles or by-laws, the power to do this resides in the directors of the corporation. As a general rule, the by-laws of a corporation provide for regular meetings of the stockholders. The time and place are usually fixed. Meetings of the stockholders of a corporation must ordinarily, although not necessarily, take place in the state where the company was organized. At common law, personal notice of corporate meetings, definite as to place and time, had to be communicated to each individual stockholder. If this was not done, the proceedings of the meeting were invalid. In the absence of statutory or charter provision, or of some rule in the corporate by-laws, this common-law doctrine still prevails. Today the matter is ordinarily regulated in such manner that notice can be given by publication. Sometimes, notice through the mail is also provided for. The current columns of any metropolitan newspaper contain daily advertisements of the annual meetings of the large corporations. If a special meeting is called, the notice of the corporate meeting, inserted in the newspapers and sent through the mail

to the different stockholders, should set forth what the nature of the business to be transacted will be.

At common law, a majority of the members present at a corporate meeting were regarded as a quorum. By a quorum is meant that number of shares of stock which must be present in order that business may validly be transacted. It is now ordinarily required that a majority of the outstanding shares of capital stock be represented at the stockholders' meeting in order to constitute a quorum. Stockholders are not required to attend meetings in person, but may, if they choose, be represented by proxy. Under this system, a single stockholder possessed of a sufficient number of proxies to make a majority of the shares of capital stock, might hold a corporate meeting all by himself, transact business, and elect corporate officers for the next year, provided only that the meeting has been properly called. This was frequently done, in New Jersey, for example, when that state was constituting itself a public nuisance and menace in the ease and facility with which corporations were treated there.

171. **Capital stock and capital.**—By the capital stock of a corporation is not meant its share stock, but it means "that money or property which is put in a single corporate fund by those who by subscription therefor become members of a corporate body."[68] In Barry v. Merchants' Exchange Co.,[70] Vice-Chancellor Sanford said: "The capital stock of a corpo-

[68] Burrall v. Bushwick R. Co., 75 N. Y. 211.

[70] 1 Sandford's Ch. 280 (N. Y.). LEADING ILLUSTRATIVE CASES. See also Commercial Fire Ins. Co. v. Board of Revenue, 99 Ala. 1, LEADING ILLUSTRATIVE CASES.

ration is like that of a co-partnership or joint stock company, the amount which the partners or associates put in as their stake in the concern." Perhaps the capital stock of a corporation might be best defined as that total amount, whether in funds or property, which the associates have dedicated to the purposes of the proposed corporate enterprise. It remains a fixed sum in amount, and does not vary. It is the fund upon which creditors rely, and have a right to rely, in dealing with the corporation. In a certain sense of the word, it is the corporate pocketbook. By loss or misfortune, or misconduct, the capital stock of a corporation may be reduced below the amount limited by its charter; but whatever property it has up to that limit must be regarded as its capital stock. When its property exceeds that limit, then the excess is surplus. Such surplus belongs to the corporation and is a portion of its property, but in a strictly legal sense it is not a portion of the corporate capital stock. The surplus, unlike the capital stock, may be divided in the form of dividends among the stockholders. The surplus might be defined as that amount of money over and beyond the capital stock earned through the judicious business use of the capital stock by the directors and managing officers of the corporation.

By the capital of the corporation is meant the amount of money and property possessed by the corporation. It may be the same as the capital stock, but it is generally either more or less. It consists of the capital stock as fattened and increased by profits and by wise management, or as lessened and dimin-

ished by losses and foolish management or unfortunate business reverses. Capital might be briefly defined as the whole amount of corporate property, existing at any given time, of whatever kind or nature.

172. **Capital stock distinguished from shares of stock.**—Suppose that the entire capital stock of a corporation is invested in real estate. Are the shares of stock in the corporation real estate or personal property? The judgment of our courts is that the shares are personal property because the individual shareholder has only a right of action for a sum of money, namely, his part of the net profits or dividends. In the early English cases, this distinction, now well understood, between the property of a corporation and the rights of its members, does not seem to have been taken. It was assumed that each shareholder had an estate in the corporate property and that consequently if that property was real property, his share was also real estate. In this country, however, and also in modern England, the distinction between the capital stock of the corporation and the shares of stock of the stockholders is fully recognized. The property of a corporation may be mainly, if not wholly, realty, and yet the shares of its members are personalty.[71] We have already seen, in considering the subject of corporate taxation, that both the capital stock of the corporation and the shares of stock in the possession of the shareholders, may be lawfully taxed. This emphasizes the distinction between the two. The legal property of the shareholders is quite

[71] Russell v. Temple, 3 Dana's Abr. 108 (Mass.); Johns v. Johns, 1 Ohio State 350.

distinct from that of the corporation, although the shares of stock have no value save that which they derive from the corporate property, surplus, and franchise. The owners of the shares of stock, as we have seen, do not own the property of the corporation. The corporation itself, the legal entity, owns that property. The owner of the shares of stock in a corporation only has a right through his ownership to share in the profits earned by the corporation, and to a proportionate share of its property after dissolution and payment of its debts. He has that interest in the proportion that the number of his shares of stock bears to the whole number of shares of capital stock.

While the nominal, or so-called par, value of the capital stock and of the shares of stock are the same, the actual value is often widely different. Let us suppose a corporation is formed with a capital stock of one hundred thousand dollars, divided into one thousand shares of a par value of one hundred dollars each. At the outset we will assume that both the shares of stock and the capital stock are worth one hundred thousand dollars. The capital stock may be lessened in amount as the result of a fire destroying much of the corporate property; and yet the faith of the public in the corporate enterprise may be such that a share of stock in the corporation will be quoted in a stock exchange at two hundred dollars, making the total value of the shares of stock two hundred thousand dollars. Remember that the capital stock belongs to the corporation, whereas the shares of stock belong to the individual shareholders.

173. **Nature of shares of corporate stock.**—A share of stock in a corporation is personal property and is in the nature of a chose in action. "Shares of stock are in the nature of choses in action, and give the holder a fixed right in the division of the profits or earnings of a company so long as it exists and of its effects when it is dissolved."[72] The certificate of stock is the evidence of the shareholder's title to his shares of stock. The interest of the shareholder enables him to participate in the net profits earned by the corporation in the employment of its capital, during the existence of its charter in proportion to the number of his shares; and upon its dissolution or termination, to his proportion of the corporate property that may remain after the payment of the corporate debts. It is, in a word, the right to participate in a certain proportion in the immunities and benefits of the corporation.[73]

The property of every corporation may consist of three separate and distinct things, which are its capital stock, its surplus, and its franchise. These three things, several in the ownership of the company, are united in the ownership of the shareholders. "The share stock covers, embraces, represents all three in their totality, for it is a business photograph of all the corporate possessions and possibilities." Into the value of shares of stock there enters still another factor, namely, stock market speculation. This often causes fluctuations in the quoted price of a share of stock in a corporation unrelated in any manner to the

[72] Folger, J. in the leading case of Kent v. Quicksilver Mining Co., 78 N. Y. 159.

[73] Porter v. Rockford, etc., R. Co., 76 Ill. 561.

actual inherent worth of the stock and of the assets and corporate possibilities which it represents.

174. **Kinds of stock.**—Shares of stock are of various kinds, such as common, preferred, guaranteed, interest-bearing, special, treasury, deferred, founder's shares, watered, fictitious and surplus. These will be briefly explained.

Common stock. Shares of common stock entitle their owners to an equal proportional participation in the management, profits, and surplus or assets in case of dissolution.

Preferred stock. Preferred shares entitle the owners to some preference in the distribution of profits, or of assets, over the owners of the common stock. Such shares may be either cumulative or non-cumulative as to profits up to a certain fixed amount; if cumulative, a deficiency in paying the profits for any one year must be made up out of the profits of succeeding years before the common stock is entitled to receive profits. In the absence of preferred stock being expressly made cumulative, it will still be held to be so. Preferred shareholders have a right to participate in the management and are subject to liabilities as other shareholders.

Preferred stock is not always of the same nature. Ordinarily it is understood as designating such stock as is entitled to dividends from the income, or earnings, of the corporation before any other dividend can be paid. But, though this may be true, yet to determine in each case the special properties and qualities which it possesses, resort must be had to the statute or contract under which it was issued. Preferred

stock takes a multiplicity of forms, according to the desire and ingenuity of the stockholders and the interests of the corporation itself. It is a matter of contract, or depends upon statute. It is not regarded as corporate indebtedness. The right of a holder of a certificate of preferred stock is not against the company as for a debt, but his right is to a dividend. Very often preferred stockholders are deprived of voting power in consideration of the preferences over the common stock which is given them. Where there is provision made for a preferential dividend but there is no provision made for division of capital on the dissolution of the corporation, preferred and ordinary shareholders share equally, and the assets must be distributed without regard to their rights in respect to dividend.

Guaranteed stock. Guaranteed shares in the United States now mean substantially the same as cumulative preferred shares.

Interest-bearing stock. Interest-bearing shares are such as bear interest upon all sums paid in until the corporation is completed and profits earned out of which to pay dividends. Such payment, however, is held to be illegal as against creditors who might be injured thereby.

Special stock. This is a peculiar kind of stock provided for by law in Massachusetts, and limited to two-fifths of the actual amount of capital of the corporation, subject to redemption at a certain time, and drawing interest at a fixed rate, and without liability of the holder beyond the amount subscribed.

Treasury stock. By treasury stock is meant that

part of the authorized capital left in the possession of the corporation, to be issued in the future by the corporation, or upon further subscription. The term is also used to designate stock that has once been issued but surrendered or forfeited to the corporation, and afterwards reissued by it. It cannot be voted nor does it draw dividends.

Deferred stock. This stock draws no dividends until some other class of shares receive their dividends.

Founder's shares. These entitle the holder to all the profits after certain fixed maximum dividends are paid to the other shareholders.

Watered stock. By watered stock is meant stock which on its face purports to have been paid for at its full value, but which in fact has been issued without the corporation having anything back of it for which to demand the full face value. It has mere "water" instead of substance in back of it.

Fictitious stock. By this is meant practically the same as watered stock or shares.

Spurious stock. When stock is issued in excess of the amount authorized, it is spurious, or void, and the holder of such stock does not become a member of the corporation. It is sometimes called "over-issued" stock.

175. **Transfer of shares of stock.**—Shares of stock are usually regarded as "goods, wares and merchandise" within the seventeenth section of the Statute of Frauds. Therefore the provisions of that statute must be complied with in order validly to transfer them. In a few jurisdictions no written instrument

is necessary, as shares of stock are regarded without the operation of the Statute. Since shares of stock are regarded as personal property, they go to the personal representative of a deceased stockholder and are distributed like other personal property. At the early common law, shares of stock could not be taken on attachment or on execution; their incorporeal nature was thought to prevent this. To-day, by statute, they may ordinarily be attached. Shares of stock are generally evidenced by a stock certificate. Such a certificate is ordinarily engraved upon a good quality of paper and generally reads: "This is to certify that John Doe is the owner of one hundred shares (or any specified number) of the capital stock of the ABC Corporation, of the par value of One Hundred Dollars each, fully paid up, and transferable only upon the books of the company upon the surrender of this certificate duly endorsed." This certificate is usually signed by the president, and countersigned by the secretary, under the seal of the corporation. Upon the back is usually the form of an assignment which may read, "For value received, I hereby assign and transfer all my right, title and interest to the shares in the ABC Corporation, evidenced by this certificate, to YZ, and I do hereby appoint YZ to be my agent or attorney in fact, for me, and in my name to have the transfer of the same made upon the books of the company." This assignment will be signed by the owner and delivered to YZ. It is not necessary to fill in the name of the purchaser, nor the name of the attorney to make the transfer. These may be left blank, and after the delivery of the certificate

to YZ, the purchaser, he may, by mere delivery of the certificate, sell it to some one else, and this person to another, and so on, and the last purchaser may fill in his own name and the name of some person to make the transfer on the books of the corporation, surrender the certificate, have the transfer made to him upon the books, and receive a new certificate in his own name.

The corporate records, such as the subscription or transfer book, are prima facie (presumptive) evidence as to who are lawful members of the corporation. However, these books are not conclusive. A person whose name happens to be registered on the books of the company may not, in fact, be a stockholder. For instance, he may have presented a forged transfer of the certificate of stock to himself, and the corporation, acting thereon, may have entered his name erroneously as that of a shareholder. In the same way, one whose name does not appear upon the corporate books may, in fact, be a stockholder. For example, A sells his stock to B, and gives B the certificate of stock, duly endorsed. Until B has the transfer registered on the books of the corporation, his name will not appear as stockholder, although he (B) is the stockholder in fact.

176. **Restraints upon transfer.**—Unreasonable restraints cannot be imposed upon the transfer of shares of stock. The reason is that they are personal property, and the common law does not sanction narrow restraints upon alienation. In a leading English case, however, it was recently held that provisions in the articles of a private corporation, compelling a

stockholder desiring to sell his shares at any time during the corporate existence to sell them to certain particular persons at a fixed price, were valid. These provisions were not regarded as repugnant to, or inconsistent with, absolute ownership.[74] In Maryland, a similar provision was held invalid. An early Massachusetts case regarded a by-law limiting the right of transfer of stock to assignment at the corporate office personally or by attorney, with the president's consent, as void.[75] In a recent decision, an action was brought in tort for the conversion of twenty shares of stock in a brewing company because of a refusal to transfer the stock to the plaintiff on the books of the company. The certificate was transferable only in accordance with the by-laws of the company, which were printed upon the back of the certificate itself. One of these by-laws forbade a transfer or disposition of the stock unless the stockholder, at least thirty days previous thereto, should have offered in writing to sell the same to the board of directors upon the same terms and the offer had not been accepted. There was no evidence in the records that any such offer had been made. The court directed a verdict for the defendant, and this was affirmed on appeal. The court said that it saw no reason of public policy which would dictate the invalidity of the by-law. Chief Justice Holmes said: "Stock in a corporation is not merely property. It also creates a personal relation analagous otherwise

[74] Borland's Trustee v. Steel Bros. & Co., Limited (1901), 1 Ch. Div. 279 (Eng.).

[75] Sargent v. Franklin Ins. Co., 8 Pick. 90 (Mass.).

than technically to a partnership. Notwithstanding decisions under statute, there seems to be no more objection to retaining the right of choosing one's associates in a corporation than in a firm."[76] It has been held that a corporation has no power, in the absence of a provision to that effect in its articles of incorporation, to create a lien upon its stock by by-law for debts of the shareholder to the company.[77] It is legally impossible, thus, to abridge the right of transfer. Power may be given by statute to do so. There may also be, in some cases, an agreement of the original stockholders among themselves, that such power shall exist. National banks are prohibited by statute from declaring a lien upon the transfer of their stock because of the indebtedness of a shareholder.

The corporation is ordinarily regarded as without power to prevent a transfer of shares of stock to a purchaser thereof, even though it may think that the transfer is injurious to it. Suppose that X, an enemy of the Standard Oil Company, purchases one hundred shares of its stock, in order that he may attend the next stockholders' meeting and protest against the management of the company. It was held in Rice v. Rockefeller,[78] that inquiry into the motive of the purchaser cannot be allowed. It has been decided, however, that registration may be refused where the purpose of the purchaser was to wreck the corporation. In general, a corporation is not at liberty to

[76] Barrett v. King, 181 Mass. 476, 63 N. E. 934.
[77] Driscoll v. West Bradley & Cary Mfg. Co., 59 N. Y. 96.
[78] 134 N. Y. 174, 31 N. E. 907.

inquire into the motives of the vendor and the vendee of the stock, the purpose which prompts the transfer, or what will be its effect.

177. **Effects of executed transfer.**—The general rule is that the transferor of shares is no longer a member, and is no longer in any way liable to the corporation or its creditors, even though the shares are not fully paid; the purchaser, on the other hand, assumes, if he has knowledge of the facts, all the obligations, and is entitled to all the rights of the seller. If he has no knowledge that the shares were not paid up, in the absence of any statute to the contrary, he is not liable to the corporation or its creditors.

The assignee of stock takes the shares of stock with all their rights and liabilities, so that if a liability to a loss has been incurred by the corporation before he purchased the stock, he may be called upon to contribute thereto as soon as he has accepted a transfer of the shares and has become a stockholder in the company. The liability to pay the call made upon shares of stock, after the transfer, is shifted from the outgoing to the incoming stockholder. The transfer of stock works a complete substitution, or novation, of the contract of membership. The transferee is substituted in the place of the transferor, with all the rights and liabilities incident to the holding of the shares of stock.

If the law implies a promise by the original holders of stock to pay the full par value when it may be called, it follows that an assignee of the stock, when he has come into privity with the company by hav-

ing stock transferred to him on the books of the company, is equally liable. The same reason exists for implying a promise by him as exists for raising up a promise by his assignor.[79]

The effect of an executed transfer may also result from a transfer of the shares of a corporation on the books of the company by the transferor to the name of the transferee, without any delivery or assignment of the certificate of stock. In a Missouri case,[80] an action was brought to recover damages for D's failure to deliver certain railroad stock which D had agreed to sell and deliver to P. The answer of D alleged that he had had the shares transferred on the books of the corporation to P. P maintained that the delivery of the certificate of stock to him was essential. D insisted that a transfer of the stock to P on the books of the corporation was what was necessary, and all that was requisite. The court decided in favor of D. Judge Dryden said: "The end the parties intended to accomplish was to confer upon the plaintiff's testator the title and ownership of the stock contracted for. The delivery of the certificates from one party to the other would leave the title to the stock just where it was before. The only effectual mode of transferring the title was by a transfer on the books of the company, and by that means only."

On the other hand it has been held that a valid gift of shares of stock may be made by mere delivery of the securities to the donee without any assignment

[79] Webster v. Upton, 91 U. S. 65, 23 L. Ed. 384.
[80] White v. Salisbury, 33 Mo. 150.

or even an endorsement in writing.[81] The theory of this decision is that shares of stock are only choses in action, that the certificates of stock are evidence of the title to them, that registration is not essential to the validity of the gift, and that a mere delivery of the certificates should invest the donee with an equitable title to the shares. In several jurisdictions, including Maryland and New Jersey, the rule is otherwise, and such a gift is not recognized as valid. In jurisdictions, however, where it is upheld, the effects of a complete executed transfer follow.

178. **Registration of transfer.**—There are two theories as to the necessity of the registration of the transfer of shares on the books of the corporation;—one is that the legal title does not pass by the delivery of the certificate duly endorsed and assigned, but that registration is essential to pass the legal title, only the equitable title passing until such registration is made; the other theory is, that as between the parties themselves, and all other parties claiming through them, the whole title passes by the delivery of the certificate of stock, duly endorsed, with a power of attorney to have the transfer made on the books of the company. As between the corporation and the transferor or transferee, until the registration is made on the books of the company, the corporation may, until it is satisfied of the right of the transferee, recognize the registered owner. The above rules become of importance in the case of attaching creditors of the transferor, and give exactly opposite results as we shall see. As between pledgor and

[81] Commonwealth v. Crompton, 137 Pa. St. 138, 20 Atl. 417.

pledgee, registration is unnecessary. But the pledgee in order to prevent the possibility of loss, usually has the stock registered in his name.

179. **Same subject—Rights of attaching creditors.**—Perhaps no subject in the entire law of corporations has caused more dispute than the right of attaching creditors of a stockholder where he has transferred his stock to another, and the transferee has failed to have the transfer recorded on the corporate books. The one theory insists that the transferee of the stock has no rights inasmuch as the stock was attached by the creditor before the transferee was registered as the owner of the shares on the books of the company. These decisions emphasize the fact that registration is essential in order to pass the legal title. They insist that until registration of the stock, the transferee only possesses an equitable interest which may be cut off. In Alabama, Colorado, Connecticut, Indiana, and many other states, this view is adopted, and the attachment creditor prevails as against the unrecorded transferee. In California, the attachment creditor prevails provided he has no notice of the unregistered transfer. In several important jurisdictions, including Michigan, Minnesota, New Jersey, New York and Pennsylvania, the unregistered transferee prevails over the attaching creditor at common law. This is analogous to the common law rule prevailing in New York, that the assignee of an ordinary chose in action prevails over subsequent attaching creditors. If there are several successive assignments, the first one in point of time prevails. In several states, for example, Illinois, Maryland, Massachu-

setts and Wisconsin, statutory provisions safeguard the right of the unregistered transferee of the stock. These decisions result from the desire to make corporate stock as nearly negotiable as possible. In Massachusetts, it has even been held that an unregistered transferee of a certificate of stock gets a good title to the shares as against a previous attaching creditor; this, of course, is the result of the statute.

There are several strong reasons why an unrecorded transfer to a bona fide transferee should have preference over an attachment. First, in the absence of statute, creditors take the property of their debtor subject to all honest and bona fide liens, and equitable transfers. The non-recording of a transfer of stock is not evidential of fraud. It is not similar to such cases as those where a vendor, after a sale, retains the physical possession of the chattels sold. Second, the delivery of a certificate of stock, and the assignment with power to transfer, is a sufficient delivery at common law. Third, the overwhelming tendency of modern decisions is to regard certificates of stock attached to an executed blank assignment, and power to transfer, as approximating negotiable securities, though negotiable neither in form nor character. Finally, the able judges in the federal courts have repeatedly given unrecorded transfers of stock made in good faith and for value, precedence over subsequent attachments in behalf of creditors of the vendor, or over the claims of creditors. In most of the states to-day, the subject is governed by statute. These statutes, as a rule, protect the unrecorded transferee. The reason for the enactment of these stat-

utes is found in the desire of business men, of dealers in stocks, and of the community in general, to have certificates of stock regarded as substantially similar to negotiable instruments. The free transfer of shares of stock is one of the reasons why the corporate form of organization has become so popular and prevalent. The desire of the law to subserve the wishes of the business community is found in the many modern cases tending to facilitate quick, simple and easy transfers of stock, at the same time affording protection to the transferee. The whole title, legal and equitable, to a certificate of stock, is now regarded as passing by the delivery of the certificate, duly endorsed, with a power of attorney to the transferee to have the transfer entered to him and to his name on the corporate books.[82]

180. **Transfer upon forged power of attorney.**— The transfer of shares of corporate stock by the corporation, upon a forged power of attorney, cannot affect the rights of the original owner of the stock. In the absence of negligence on his part, it stands to reason that he cannot be deprived of his property by forgery. In a famous English case,[83] T was the registered holder of five shares in a railway company. A transfer of the five shares to S and G, purporting to be executed by T, but which was a forgery, was left with the corporation for registration. The names of S and G were placed upon the register as holders of the five shares, and certificates for the

[82] See Scott v. Pequonnock Nat. Bank, 15 Fed. 494; Rice v. Gilbert, 173 Ill. 348, 50 N. E. 1087.

[83] In re Bahia & San Francisco R. Co., L. R. 3 Q. B. Cas. 584 (Eng.).

shares were given to them. Subsequently, S and G sold the five shares to two innocent purchasers for value without notice. The corporation was ordered to restore the name of T to the register of shareholders. This, of course, was sound. Forgery could not deprive T of an interest in the stock. The next question which arose was whether the two innocent purchasers for value could recover against the company. It was held that they were entitled to recover from the corporation the value of the shares at the time they ceased to be recognized as stockholders. This also is sound. The company is bound to keep a register of stockholders and has power to issue certificates certifying that the shareholder named therein is the registered holder of the shares specified. This amounts to a declaration by the company to all the world that the person to whom the certificate is given is a shareholder. It is given by the company with the intention that it shall be used by the person to whom it is given, and acted upon in the sale and transfer of shares. If it turns out later that the transferors had, in fact, no shares, as where the transfer to them was a forgery, the company is responsible since it ought not to have registered them as shareholders or given them certificates. This rests upon the theory that where a representation is made with the intention that it shall be acted upon, and it is acted upon, the person making the representation is estopped from denying the truth of what has been represented to be the fact. Thus, the corporation held out S and G as stockholders. This was erroneous. The subsequent innocent purchasers for value relied thereon and were

deceived thereby. Accordingly, an estoppel arises against the corporation. The remedy of the corporation is against the forger, or against the person who induced the corporation to act. A recovery can be had against such person, even though innocent, on the ground that he impliedly warrants to the corporation that the transfer to him is genuine. As between two innocent persons, he, on the one hand, and the corporation, on the other, the loss should be borne by him, since he caused the corporation (although innocently) to act upon the transfer which turned out to be invalid.[84]

181. **Transfer in abuse of authority.**—Suppose the owner of a stock certificate, indorsed in blank, entrusts it to another, for example, to a stock-broker as security. Under these circumstances, the owner does so charged with notice of the power to deceive which he is putting into the hands of that other person. He knows, or as a reasonable man should know, that the holder of a certificate of corporate stock indorsed in blank may act in breach of trust or in excess of the authority under which the stock is held. In these cases, the true owner, having conferred on the trustee or bailee all the outward appearances of ownership of the stock, that is, the possession of the certificate indorsed in blank, is forbidden to assert his title to the stock against one who purchases from the bailee or trustee, in good faith and for value. This is another application of the doctrine of estoppel. The owner of the stock has put it into the power of

[84] Sheffield Corporation v. Barclay, (1905) A. C. 392 (Eng.); Boston & Albany R. Co. v. Richardson, 135 Mass. 473.

the person to whom he entrusted his stock certificate indorsed in blank, to deceive the world in general.

The leading American case, perhaps, is McNeil v. Tenth National Bank.[85] Here, the owner of one hundred and thirty-four shares of bank stock entrusted them to his brokers, in order to secure them for any balance which might become due on the account. The certificate was endorsed in blank with a power of attorney to transfer also written thereon. The stock-brokers fraudulently transferred the certificate to an innocent purchaser for value. The court decided that the original owner had conferred upon his brokers such an apparent title to, and power of disposition over, the shares in question as to estop him from asserting his own title against the innocent third parties who took bona fide through the brokers. Simply entrusting the possession of a chattel to another as depositary or pledgee is clearly insufficient to preclude the real owner from reclaiming his property, in case of an unauthorized disposition of the chattel by the person entrusted with it. On the other hand, if the owner entrusts to another, not merely the possession of the property, but also written evidence over his own signature, of title thereto, and of an unconditional power of disposition over it, the case is vastly different. The holder of a certificate of stock with signed power of attorney possesses all the external indicia of title to the stock. He has an apparently unlimited power of disposition over it. And third persons dealing with him in good faith on the strength of the instrument should be, and are, pro-

[85] 46 N. Y. 325, Leading Illustrative Cases.

tected. In a recent Massachusetts case,[86] X entrusted a certificate of stock, indorsed in blank, to her dishonest attorney. He, instead of using it for the purpose for which it was entrusted to him, obtained a loan from Y by giving the stock certificate in pledge. It was held against X, "upon the principle that when one of two innocent persons is to suffer, the sufferer should be the one whose confidence put into the hands of the wrongdoer the means of doing the wrong." It is unfortunate that X entrusted the possession of the certificate, indorsed in blank, to the agent for one purpose and that he fraudulently used it for another. This, however, does not avail X. X knew that an instrument was being placed into the agent's hands which made actual deceit possible. In other words, X took the risk of the appearances being interpreted as it is usual for business men to interpret them. Such cases as these must be carefully distinguished from cases where the stock certificate, endorsed in blank, has been stolen from its owner or lost without any negligence on his part; under these conditions, it is well settled that the owner has the right to reclaim the stock from the hands of any person into whose possession it subsequently comes, although the holder may have taken it in good faith and for value.[87] Where the certificate is lost or stolen from the true owner without negligence on his part, the doctrine of estoppel cannot be invoked against him. A different rule applies from what is established, in the interest

[86] Russell v. Amer. Bell Tel. Co., 180 Mass. 467, 62 N. E. 751.

[87] Knox v. Eden Musee Amer. Co., 148 N. Y. 441, 42 N. E. 988; Scollans v. Rollins, 179 Mass. 346, 60 N. E. 983.

of the currency, with regard to bank notes and to negotiable instruments. These cases must also be distinguished from cases where the agent or servant merely has access to a stock certificate remaining in the possession of the owner, and where the master is not precluded from reclaiming it, if wrongfully taken by the servant and sold to another. Thus, where stock certificates were placed in a safe of which a servant had the key it was held that there was no estoppel against the master to reclaim them from a bona fide holder to whom the agent had fraudulently delivered them.

182. **Quasi-negotiability of stock certificate.**— Stock certificates are not negotiable instruments. They do not, like negotiable instruments, run to the bearer or to the order of the person to whom they are given. They simply declare that the person named in the certificate is entitled to a certain number of shares of stock. They contain no words of negotiability. If they were negotiable instruments, a bona fide purchaser of a stolen stock certificate would get good title; we have seen that this is not the case. On the other hand, certificates of corporate stock possess certain attributes of negotiability. As has been said by Chief Justice Cullen of New York: "Certificates of stock are neither choses in action nor negotiable instruments; but both in England and in this country it has been sought to render dealings in stocks practicable and to secure the rights of purchasers by giving the stock certificates attributes of negotiability to a certain limited extent."[88] Courts

[88] Central Trust Co. v. W. India Imp. Co., 169 N. Y. 314, 62 N. E. 387.

have been frequently urged to extend the negotiable qualities of stock certificates. They have been asked to clothe them with the same character of complete negotiability as attaches to ordinary commercial paper, so as to make a transfer to a purchaser in good faith, for value, equivalent to actual title, although there was no agency in the transferor, and the certificate had been lost without the fault of the owner or had been obtained by theft. The courts have refused to yield to this. No well-considered case denies to the owner of a stock certificate which has been lost without his negligence, or stolen, the right to reclaim it from the hands of any person into whose possession it may thereafter come, although such person may have taken it in perfect good faith and paid a valuable consideration. If the quality of complete negotiability is to be conferred upon stock certificates this will have to be done by the state legislatures. It cannot be done under the common law.

183. **Refusal to transfer.**—There are three possible remedies for a wrongful refusal to transfer stock upon the books of the corporation to a purchaser thereof: (1) An action may be brought in a court of law to recover the value of the shares of stock as damages. The value of the stock ordinarily is its market price at the time of refusal. Some courts, however, allow the value at the time of the trial, or at any time between the refusal and the trial. (2) By proceedings in equity to establish his corporate membership. (3) By mandamus proceedings to compel the corporation to transfer the stock.

CHAPTER XII.

SAME TOPIC—THE RIGHTS OF STOCKHOLDERS.

184. **Right to perform extraordinary corporate acts.**—Such extraordinary acts as the increase or decrease of capital stock, an addition to or a change in the corporate business, or a determination to alienate the entire corporate property, must be performed by the stockholders. The directors, as we have seen, have authority only to carry on the ordinary matters that come up in the course of the business of the corporation. They lack authority to perform vital and fundamental transactions. Where authority to perform acts is vested in the stockholders, they must be authorized at a duly assembled meeting of the shareholders.

185. **Right to vote.**—The right to vote for directors and upon propositions to increase the stock or mortgage the corporate assets, is perhaps the most important power which the stockholder has. So long as the management is honest and within the corporate powers, the stockholders cannot interfere, even though the administration is weak and unsatisfactory. They must correct such an evil through their power to elect other directors. Hence, the power to vote is vital. "The right to vote for directors, therefore, is the right to protect (the corporate) property from loss and make it effective in earning dividends. In other words, it is the right which gives the property

value and is part of the property itself, for it cannot be separated therefrom. Unless the stockholder can protect his investment in this way he cannot protect it at all, and his property might be wasted by feeble administration and he could not prevent it. He might see the value of all he possessed fading away, yet he would have no power, direct or indirect, to save himself or the company from financial downfall. With the right to vote, as we may assume, his property is safe and valuable. Without that right, as we may further assume, his property is not safe and may become of no value. To absolutely deprive him of the right to vote, therefore, is to deprive him of an essential attribute of his property."[89]

Stockholders are not disqualified to vote upon a matter coming before a stockholders' meeting because they have a personal interest in the matter to be voted upon. For example, stockholders can vote upon a proposition to ratify a purchase of property from themselves, which they, as directors, had assumed to make on behalf of the corporation.[90] The stockholder cannot be deprived of his voting right because he proposes to use it for purposes which others may think to be detrimental to the interests of the corporation.

At common law every member of a corporation had only one vote, regardless of how many shares of stock he owned. But now, almost universally, the rule is otherwise and each stockholder has the right to one

[89] Lord v. Equitable Life Assur. Soc., 194 N. Y. 212, 228, 87 N. E. 443, 448.

[90] Bjorngaard v. Goodhue Co. Bk., 49 Minn. 483, 52 N. W. 48.

vote for each share of capital stock of the corporation held by him. Thus, if A owns eight hundred and fifty shares of stock in a corporation, he has to-day eight hundred and fifty votes; whereas at common law he would have but one vote. The corporation statutes generally make the books of the corporation conclusive evidence of the ownership of stock and of the right to vote in virtue of such ownership. The right to vote follows the legal title. For example, as between pledgor and pledgee the right to vote remains in the pledgor if the legal title is still his; while if the legal title was transferred to the pledgee his prima facie (presumptive) right to vote would be equally clear. Executors and administrators may vote the stock belonging to the estate which they represent before distribution. It is held that a corporation cannot vote its own shares itself. It may, however, vote shares of stock in another corporation which it has purchased. Bondholders have no voting rights. Preferred stockholders usually, but not always, can vote.

186. **Same subject—Voting by proxy.**—At common law a stockholder was required to attend in person at meetings of the corporation. The right of the corporation to authorize any stockholder to vote by any power of attorney or proxy was denied. In other words, shareholders had no common law right to vote by proxy. The reason for this rule was that each stockholder was expected to exercise his individual judgment upon all measures. To-day, the right to vote by proxy is ordinarily conceded by statute. In some jurisdictions, corporate by-laws authorizing

proxy voting have been declared valid in the absence of any statutory authorization. Notwithstanding these statutes, many questions have arisen as to the extent to which stockholders may authorize their proxies.

187. **Same subject—Voting trusts.**—Of recent years the voting trust has become very common. A voting trust might be defined roughly as an agreement between certain shareholders in a corporation to vote the shares of stock which they own in such manner as the majority of the shareholders who are parties to the voting trust agreement shall direct, or in the way some designated trustee of the stock or third party shall direct. In some jurisdictions, voting trust agreements are regarded as illegal and void. In a North Carolina case it was said: "In short, all agreements and devices by which stockholders surrender their voting powers are invalid. The power to vote is inherently annexed to and inseparable from the real ownership of each share, and can only be delegated by proxy with power of revocation."[91] In the famous Shepaug Voting Trust Cases,[92] the law of Connecticut was similarly enunciated. On the other hand, in California, Illinois, Massachusetts, New Jersey and New York, the voting trust is sanctioned provided that its purposes and object are proper and reasonable.[93] While a proxy is ordinarily regarded as revocable at the will of the stockholder, yet where the voting trustees are vested with rights in the nature

[91] Harvey v. Linville Imp. Co., 118 N. Car. 693, 24 S. E. 489.

[92] 60 Conn. 553.

[93] Smith v. San Francisco, etc., R. Co., 115 Cal. 584, 47 Pac. 582; Brightman v. Bates, 175 Mass. 105, 55 N. E. 809.

of a power coupled with an interest, the stockholders cannot revoke. In general, it might be said that the legality of these much discussed agreements will depend almost entirely upon the motives and objects with which they are made. If the attempt is to obtain monopoly or to restrain trade, by the medium of a voting trust, then it is void as against public policy. On the other hand, it is not illegal simply to separate the voting power of stock from its ownership. The very right to vote by proxy itself implies that the voting power may be separated from the ownership of stock. Where stockholders vest the voting rights of stock in trustees, the mere naked legal title to the stock, coupled with the voting rights, is in the trustees. All the other beneficial rights of stock ownership remain in the shareholders. For example, they still receive the dividends.

188. **Same subject—Cumulative voting.**—Cumulative voting is a method, unknown to the common law, but authorized frequently to-day by statute, and is designed to allow the minority of shareholders to obtain representation upon the directorate of the corporation. It may be illustrated thus: A owns ten shares of stock in a corporation having five directors, and would ordinarily only have the right to vote his ten shares for each of the five directors, or fifty for all of them; the "cumulative vote" permits him to vote his fifty votes for one director, instead of ten for each of the five directors as he is ordinarily compelled to do; or he may cast twenty-five votes for each of two candidates, and none for the others, or make such cumulation or separation

of his votes as, in his judgment, will best serve his interests in getting representation in the directorate. In Ohio, a constitutional provision secures and insures this right.

189. **Right to make by-laws.**—By a by-law is meant a rule adopted for the permanent government of the internal management of the corporation and its officers. The power to enact by-laws resides primarily with the stockholders. It is a power that the directors have no inherent right to exercise. This is reasonable, for the stockholders should have a right to say by what rules their corporation shall be governed. In some states, however, including Illinois, the power to adopt by-laws is vested by statute in the board of directors. Strangers to the corporation cannot be bound by the by-laws adopted for the internal government of the company. The by-laws of a private corporation bind the members thereof only by virtue of their consent. They do not affect the outside parties. This seems reasonable when it is recalled that the office of a by-law is to regulate the conduct and define the duties of the members towards the corporation and between themselves.[94] The following matters are ordinarily governed by provisions in the by-laws: The manner of calling and conducting meetings; quorums; the number of votes to be given by the stockholders; the powers and tenure of office of the corporate officers; the manner of voting by proxy, and the like. The proper office of by-laws is to regulate the transaction of the incidental business of a corporation. A restriction upon the free

[94] Flint v. Pierce, 99 Mass. 68.

transfer of corporate stock cannot be imposed by the majority, under the form of a by-law. A corporation cannot create or declare a lien upon its stock by by-law. Many authorities, however, including the Michigan courts, hold otherwise, and declare that a by-law creating a lien on the shares of a member for debts due by him to the corporation is valid and binding, though not as against innocent purchasers for value. The National Banking Act forbids a national bank to provide for such a lien either in its articles of association or its by-laws.[95] The ordinary corporation is generally allowed to provide for such a lien in its articles of incorporation. It is not the function of a by-law, however, to provide for this; such a by-law would be unreasonable.

190. **Right to dividends.**—A dividend is a profit earned by the corporation through the judicious use of its capital stock and declared to be set aside out of the surplus to be divided among the shareholders in proportion to their respective holdings of shares of stock.[96] A dividend is always understood as a fund which the corporation sets apart from its profits, to be divided among its members. A corporation which is making an annual dividend of ten per centum upon its capital stock is supposed to be a most prosperous corporation, because its annual net gains leave it this clear percentage, which it can pay over to its fortunate stockholders without impairing its capital. Dividends can only be declared and paid out of net

[95] Third Nat. Bk. v. Buffalo German Ins. Co., 193 U. S. 581, 48 L. Ed. 801; Bridges v. Nat. Bk., 185 N. Y. 146, 77 N. E. 1005.

[96] See Canfield and Wormser's Cases on Private Corporations, chap. VIII, § 3 (pp. 548-578).

profits. The right to declare it depends upon the state of the corporate finances at the time when the dividend is declared. "The question usually is, whether or not there would remain a net increase upon the original investment, after deducting from the assets of the company all present debts and making provision for future or contingent claims."[97] The declaration of a dividend is an emphatic assertion that the corporation is in a condition to make a division of profit and is prosperous. So generally is this understood that the making of a dividend when the capital must be encroached upon for the purpose, is looked upon as highly discreditable, if not absolutely dishonest and fraudulent. So forcibly has this been felt, that in most states the legislature has provided for penalties where dividends are declared out of anything except surplus profits, or where the corporate capital stock is divided or withdrawn.

When a dividend has been declared it becomes a debt, due to the stockholder from the corporation.[98] Until that time, the dividend is only something that may possibly come into existence. After a dividend has been declared, all community of interest in relation to such dividend, as between the stockholders themselves and between the stockholders and the corporation, is at an end. The true principle is that the dividend, from the time that it is declared, becomes a debt due from the corporation to the individual stockholder. for the recovery of which, after demand

[97] Crawford v. Roney, 130 Ga. 515, 61 S. E. 117.

[98] King v. Paterson & Hudson River R. Co., 29 N. J. Law 504; Lockhart v. VanAlstyne, 31 Mich. 76.

of payment, an action at law may be maintained. Like any other debt, it may be set off by the corporation against a debt of the stockholder to it. After declaration, the corporate earnings become the individual property of the stockholder and they are treated as severed from the common fund of the company for the use and benefit of each stockholder, in his individual right. If the declaration of a dividend by the directors creates a relationship of debtor and creditor between the corporation and a stockholder, it should follow that a board of directors may not lawfully rescind a dividend; but a Massachusetts case held otherwise, where the fact that a dividend had been declared was not made public or in any manner communicated to the stockholders.[99] This decision was recently bitterly criticized by the Appellate Court of Missouri, and was said to stand out "boldly, single and alone in this country against an unbroken line of cases."[1]

191. **Same subject—Stock dividends.**—When the corporation has earned a surplus which could be applied to the payment of dividends, and also has the power to increase its total shares of stock, it may lawfully keep the surplus cash or property and declare a stock dividend, so called, by issuing shares of stock instead, to the stockholders to an amount equal in face value to the surplus profits to be divided. "A stock divided is lawful when an amount of money or property equivalent in value to the full par value of the stock distributed as a dividend has

[99] Ford v. East Hampton Rubber Thread Co., 158 Mass. 84, 32 N. E. 1036.
[1] McLaran v. Crescent Planing Mill Co., 117 Mo. App. 40, 93 S. W. 819.

been accumulated and is permanently added to the capital stock of the corporation."[2]

In a leading New York case, Judge Earl said: "Stock dividends never diminish or interfere with the property of a corporation, and hence are not within the purview of that section (a statute forbidding the distribution of corporate capital in the shape of dividends). After a stock dividend a corporation has just as much property as it had before. It is just as solvent and just as capable of meeting all demands upon it. After such a dividend the aggregate of the stockholders own no more interest in the corporation than before. The whole number of shares before the stock dividend represented the whole property of the corporation, and after the dividend they represent that and no more. A stock dividend does not distribute property, but simply dilutes the shares as they existed before; and hence that section in no way prevented or related to a stock dividend. Such a dividend could be declared by a corporation without violating its letter, its spirit or its purpose."[3]

192. **Same subject—When equity will decree declaration.**—When a corporation has a surplus, whether a dividend shall be made, and if made, how much it shall be, and when and where it shall be payable, rest in the fair and honest discretion of the directors. This discretion is uncontrollable by the courts and will not be interfered with ordinarily. However, a court of equity can afford relief against bad faith or arbitrary and unjustifiable conduct on

[2] De Koven v. Alsop, 205 Ill. 309, 68 N. E. 930.
[3] Williams v. Western Union Tel. Co., 93 N. Y. 162.

the part of the directors in this regard. The directors are vested with a wide discretionary power, and the courts are loath to interfere with the internal management of the company by them. The mere existence of a large amount of surplus is insufficient to warrant intervention. A well-known New York case makes the good faith of the directors the ultimate test.[4] In Louisiana, a court of equity ordered the declaration of a dividend of $50,000 where a very large surplus existed. Directors must not accumulate too large a surplus and roll their profits year after year "until the great snowball has been magnified twenty diameters." This results in the practical starvation of the stockholders, especially where the corporation is a private or close one, and there is no ready market for its stock. The only sure benefit to the stockholders to be derived from the successful prosecution of the corporate business must come from the distribution of dividends.[5]

193. **Same subject—Who is entitled.**—The law is well settled that whoever owns the stock in a corporation at the time a dividend is declared owns the dividend also. A transfer of the stock afterwards will not carry the dividend with it, though it may not be paid or payable, until after the transfer.[6] Suppose X, the owner of five hundred shares of stock in a corporation, executed his will on June 1, 1905, in which he bequeathed the stock to Y. On July 1, 1905,

[4] McNab v. McNab & Harlin Mfg. Co., 62 Hun 18 (N. Y.). Affirmed 133 N. Y. 687, 31 N. E. 627.

[5] Raynolds v. Diamond Mills Paper Co., 69 N. J. Eq. 299, 60 Atl. 941.

[6] Hopper v. Sage, 112 N. Y. 530, 20 N. E. 350; Bright v. Lord, 51 Ind. 272.

dividends of 4 per cent were declared payable in thirty days. X died on July 20, 1905. Who is entitled to the dividends? They go to the personal estate of X, and not to Y. The reason is because X was the owner of the shares at the time the dividends were declared, and it makes no difference when the dividends were to be paid. If A is the owner of shares when a dividend is declared, it belongs to him, though it does not become due and payable until after A has transferred his shares to B. If A sells to B before a dividend is declared, it belongs to B, though it is declared before the transfer on the corporate books is made to B. The corporation, however, will be justified in paying to A if it has no knowledge of B's claim. If the corporation has notice, it is bound to pay the true owner. The corporation is protected only where it has acted in good faith and without notice in making the payment of the dividend to the registered owner. In some jurisdictions the customs or usages of the local stock exchange govern the payment of dividends in contracts made between its members.

194. **Same subject—Between life tenant and remainder-man.**—As between the claims of a life tenant and remainder-man to stock dividends, the cases are in conflict; one line of authorities holds that if the dividend is declared in money, it is always to be paid to the life tenant as income; while if it is a stock dividend, it is all to be paid to the remainder-man as part of the estate. Another rule is, that if the dividend is ordinary—that is, one arising from the ordinary operations of the company—it will go to the life tenant; but if extraordinary, such as declared out

of the capital when the stock is lawfully reduced,—all of it should be paid to the remainder-man. Another rule, and the one having the weight of authority, is that the courts will investigate when the dividend was earned. If it was earned before the death of the person creating the tenancy for life, and in remainder, it will go to the remainder-man. On the other hand if the dividend, in fact, represents earnings accumulated after the death of such person, it will go to the life tenant, whether it be paid in money or stock.

195. **Same subject—Setting apart of specific fund.**—If dividends are declared by the board of directors of a corporation and a specific fund is set aside for the payment of the dividend thus declared, a trust fund for the benefit of the stockholders is created. If corporate bankruptcy follows, the stockholders are not required to go in pro rata (equally) with the general creditors for such unpaid dividends; but they may proceed just as against a trustee on account of a trust fund, and recover the whole of their share of the dividend. In other words, the setting apart of a fund to pay a dividend gives a lien upon this fund to the stockholders, which they can enforce to the exclusion of the general creditors of the corporation.[7] Where no specific fund is set aside out of which the payment of the dividend is to be made, the shareholder is a mere creditor as to the amount of his dividend, and must share with the other creditors in case insolvency subsequently occurs before payment.[8]

[7] In re Le Blanc, 14 Hun 8 (N. Y.). Affirmed 75 N. Y. 598.
[8] Hunt v. O'Shea, 69 N. H. 600, 45 Atl. 480.

196. **Right to subscribe to new issue of stock.**—A share of stock is a share in the power to increase the stock, and belongs to the stockholders the same as the stock itself. There can be no doubt that the general rule is that when the capital stock of a corporation is increased by the issue of new shares, authorized by the charter, the holders of the original stock are entitled to the new stock in the proportion that the number of shares held by them bears to the whole number before the increase. In a recent decision of the New York Court of Appeals,[9] where this right was denied to a stockholder, Judge Vann said: "It (the right) is inviolable and can neither be taken away or lessened without consent, or a waiver implying consent. The plaintiff had power, before the increase in stock, to vote on 221 shares of stock, out of a total of 5,000, at any meeting held by the stockholders for any purpose. By the action of the majority, taken against his will and protest, he now has only one-half the voting power that he had before, because the number of shares has been doubled while he still owns but 221. This touches him as a stockholder in such a way as to deprive him of a right of property." It follows that a stockholder has an absolute right to the new stock in proportion to his holding of the old. This right is his property, and cannot be disposed of without his consent. If the stockholder is so situated that he cannot take the new stock himself, he is entitled to sell the right or privilege, as is frequently done. Where the new stock is not issued for cash, but is issued in payment for property, the

[9] Stokes v. Continental Trust Co., 186 N. Y. 285, 78 N. E. 1090.

stockholder does not possess this pre-emptive right to subscribe.

197. **Same subject—Where stock is original.**—The rule stated in the preceding section does not apply to cases where the untaken stock, proposed to be issued, is part of the original issue of stock. If the rule were otherwise, the first subscribers would possess a ridiculous advantage.[10] In an early Massachusetts case,[11] it was held that when a banking corporation has been organized with a capital not less than one sum and not greater than another, and had commenced with the smaller capital, and afterwards voted to increase to the larger, those who held stock in the original capital possessed a prior right to subscribe to the new stock. Assuming this decision to be sound, it must nevertheless be carefully distinguished from cases where there is no increase of capital, but merely a filling up of one both authorized and required.

198. **Right to inspect corporate books and records.**—It was formerly held in England that the right to an inspection of the corporate books and records could be exercised, against the will of the managing officers, only where there was a specific dispute about some definite corporate matter, between the stockholder and the officers. In England this rule has since been modified by statute. In America the doctrine was apparently never adopted, the cases which go furthest in that direction only holding that a dispute as to the alleged mismanagement of the corporation is enough to entitle the stockholder to an exam-

[10] Curry v. Scott, 54 Pa. St. 270.

[11] Gray v. Portland Bank, 3 Mass. 364.

ination of the books and accounts to see whether there is a ground for suit.

"The stockholders of a corporation are the equitable owners of its assets, and the officers act in a fiduciary relation as agents of the corporation and of the stockholders. They should be ready to account to the stockholders for their doings at all reasonable times, and the stockholders have a right to inspect their records and accounts, and to ascertain whether they are faithful, honest, and intelligent in the performance of their duties. There is no good reason why the stockholders, acting in good faith for the purpose of advancing the interest of the corporation and protecting their rights as owners, should not be permitted to examine the corporate property, including the books and accounts."[12]

The right of inspection includes the right to have the assistance of an expert accountant, an attorney, or other person, in making the examination. It also includes the privilege of making transcripts from the books and records for subsequent use.

199. **Same subject—Effect of wrongful motive.**—At common law, the right of inspection was not absolute. It could not be exercised for mere curiosity, or for merely speculative purposes, or vexatiously. The stockholder was not permitted to go on a fishing excursion through the corporate books. It was the duty of the court to exercise a sound discretion in order to determine whether the stockholder was acting for an honest purpose, not adverse to the corporate interests. The desire for an examination had to

[12] Varney v. Baker, 194 Mass. 239, 80 N. E. 524.

be reasonable. On the other hand, "Courts of equity are swift to protect helpless minorities of stockholders of corporations from the oppression and fraud of majorities." The rich must not be permitted to gain an undue advantage. The remedy for a refusal of the right is an action at law for damages or a petition for a writ of mandamus to compel and permit the inspection.

200. **Same subject—Statutory modifications.**—There is a settled distinction between the right of a stockholder to inspect the books and papers of a corporation under the common law, as considered in the two preceding sections, and an unlimited right given by statute. Under the former, the examination can only be compelled where the stockholder asks for it in good faith and for reasons connected with his rights as a stockholder. But where the right is conferred by statute, in absolute terms, the purpose or motive of the stockholder in making the demand for an inspection is not material and he cannot be required to state his reasons therefor. "The weight of American authority is to the effect that where the right is statutory, the stockholder need not aver or show the object of his inspection, and it is no defense under a statute granting the absolute right to inspection to allege improper purposes or that the petitioner desires the information for the purpose of injuring the business of the corporation. A clear legal right given by a statute cannot be defeated by showing an improper motive. If this were so, the stockholder would be driven from a certain definite right given him by the statute, to the realm of uncer-

tainty and speculation."[13] In New York, a court, divided, three to two, held otherwise, but the decision seems open to question.[14]

201. **Right of stockholder to sue on own behalf.** —A stockholder has a right to sue on his own behalf, although in the minority, to restrain ultra vires acts of the directors or a majority of the stockholders. He may also sue in equity to restrain fraudulent and oppressive acts of the majority. Wherever he has been wronged by the corporation, and his right is against it, he can obtain judgment against the corporation itself.[15] Thus, where a railroad corporation subscribed, or rather proposed to subscribe, the sum of one thousand pounds to the British Imperial Institute, it was held that a single stockholder, who dissented from this, could appeal to equity for an injunction to restrain this unauthorized expenditure of the funds.[16] If the act done is outside the powers of the company, any shareholder of the corporation may come into equity and say in his petition, "This company is going to do an act which is beyond its powers; stop it," and the court must thereupon issue an injunction. There is no discretion whatever in the matter.

202. **Same subject.**—Suppose X is a stockholder in a corporation which proposes to buy a large block of stock in another corporation in an attempt to estab-

[13] Venner v. Chicago City R. Co., 246 Ill. 170, 92 N. E. 643.

[14] People ex rel. Britton v. Amer. Press Assn., 148 App. Div. 651 (N. Y.), 133 N. Y. Supp. 216.

[15] Dousman v. The Wisconsin & Lake Superior Min. & Smelting Co., 40 Wis. 418, LEADING ILLUSTRATIVE CASES.

[16] Tomkinson v. S. E. R. Co., L. R. 35 Ch. Div. 675 (Eng.).

lish and maintain a monopoly of a certain business. Has an individual shareholder a right to bring a bill of injunction to restrain this? The question has been answered in the affirmative.[17] The grievance does not belong to the corporation alone. The individual stockholder would be irreparably injured if the corporation were subjected not only to fine, but also to a possible forfeiture of its franchises, for its unlawful course of conduct. The test always is,—Does the stockholder suffer an injury distinct and separate from the general injury to the company? Some courts, in answering the question suggested above, and others similar to it, return a negative answer in their decisions. They insist that the corporation alone may proceed. If it refuses to act, a stockholder may sue, but on the corporate behalf, not in his own.

203. **Right of stockholder to sue on behalf of the corporation.**—Where the corporate directors or officers have acted fraudulently, or in bad faith, or oppressively, or beyond their powers, and the transaction has been consummated, the stockholder cannot sue them at law. The reason is because there is no direct legal privity between a stockholder and the corporate officers or directors. A stockholder has an interest in the corporation and in the conduct of its officers and directors affecting its management and property, but this interest in the transactions of the officers is not direct and legal, but indirect and equitable. That it cannot be made the foundation of an action at law against the corporate officers or direct-

[17] Bigelow v. Calumet & Hecla Min. Co., 155 Fed. 869.

ors is well settled.[18] The stockholder's remedy for such a wrong is through a suit by the corporation against the guilty officers or directors; or through a bill in equity, brought on behalf of the corporation, if the stockholder has been unable to induce corporate action for the benefit of the stockholders.[19] The stockholder, before bringing suit on the corporate behalf, must make every reasonable effort to obtain relief through the corporation. Such an action cannot be maintained unless it is necessary "because of the neglect and refusal of the corporate body to act."[20] The action is only permitted in order to set in motion the judicial machinery of the court of equity, which intervenes in order to afford an adequate remedy.

204. **Same subject—Extent of remedy.**—The Supreme Court of the United States has definitely established under what circumstances a suit of this kind may be maintained.[21] "We understand the doctrine to be that to enable a stockholder in a corporation to sustain in a court of equity, in his own name, a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, there must exist as the foundation of the suit:

"Some action or threatened action of the managing board of directors or trustees of the corporation which

[18] Smith v. Hurd, 12 Metc. 371 (Mass.); Converse v. United Shoe Machine Co., 185 Mass. 422, 70 N. E. 444.

[19] Brewer v. Boston Theater, 104 Mass. 378.

[20] Continental Securities Company v. Belmont, 206 N. Y. 7, 99 N. E. 138.

[21] Hawes v. Oakland, 104 U. S. 450, 26 L. Ed. 827.

is beyond the authority conferred on them by their charter or other source of organization;

"Or such a fraudulent transaction completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with other shareholders, as will result in serious injury to the corporation, or to the interests of the other shareholders;

"Or where the board of directors, or a majority of them, are acting for their own interest, in a manner destructive to the corporation itself, or to the rights of the other shareholders;

"Or where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity.

"Possibly other cases may arise in which, to prevent irremediable injury, or a total failure of justice, the court would be justified in exercising its powers, but the foregoing may be regarded as an outline of the principles which govern this class of cases."

205. **Same subject—Conditions of suit.**—In a stockholder's suit brought on behalf of the corporation, the corporation is a necessary party defendant. The misconducting directors must also be parties. The corporation is, in substance, though not in form, the plaintiff. It is not regarded as such, however, for the purposes of federal jurisdiction. Where the stockholder sues in behalf of the corporation, he must show a cause of action in favor of the corporation with the same detail of facts as would be proper

in case the corporation itself had brought the action. He must also show, definitely and clearly, the facts which entitle him to maintain the action on behalf of the corporation. He must usually, therefore, allege and show that he tried to have corporate action taken through the proper corporate agency, to have the wrong righted, and that they refused; or that the wrongdoers were the corporate officers themselves, who had authority to have the corporation sue. If the offense charged is one that the stockholders could ratify, the courts will not interfere until they have been called together in a stockholders' meeting to pass upon the question,—unless delay would fatally endanger the plaintiff's rights. Negligent or disloyal acts of the directors or officers may be ratified. The stockholders may conclude that, after all, the transaction is for the benefit of the corporation. Ultra vires acts, however, cannot be ratified.[22] Where the stockholder sues, he must sue on behalf of himself and all the other stockholders, as representative of their collective rights. These suits are sometimes referred to as "derivative" or "representative" actions.

206. **Same subject—Who can sue.**—In New York, a stockholder acquiring his shares of stock subsequent to the transaction complained of, may maintain an action of this character.[23] In most jurisdictions, including Illinois and the federal courts, a different rule prevails. As said by Professor Roscoe Pound, while serving as a Commissioner in Nebraska,

[22] Foss v. Harbottle, 2 Hare 489 (Eng.).
[23] Pollitz v. Gould, 202 N. Y. 11, 94 N. E. 1088.

"Sound reason and good authority sustain the rule that a purchaser of stock cannot complain of the prior acts and management of the corporation."[24]

According to the weight of authority, a transferee of stock cannot sue in regard to transactions acquiesced in, or assented to, by his transferor. He holds the stock by the same title and has no greater rights than his predecessor. In Alabama, however, it is held that a bona fide assignee of an assenting shareholder may sue. But this is a minority view, and the general rule is that the disqualification of one's transferor is a valid defense to one's suit.[25]

207. **Same subject—Federal equity rule.**—In 1882, the United States Supreme Court announced Equity Rule No. 94, which constitutes the basis of the new Equity Rule No. 27, promulgated in November, 1912. This rule governs stockholders' bills in the federal courts, where most of these actions are brought, and is of the utmost importance. It reads: "Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particu-

[24] Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024.
[25] Babcock v. Farwell, 245 Ill. 14, 91 N. E. 683.

larity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action, or the reasons for not making such effort."

208. **Same subject—Defenses.**—Since a stockholder's suit on behalf of the corporation is brought in equity, it follows that it is subject to all the defenses, and governed by all the rules, of an equitable action. Unreasonable delay, or laches, as it is called in equity, will create a bar to the action. Acquiescence is also a defense, on the theory that one cannot blow hot one minute and cold the next. It is a defense to show that the shareholder bringing the action is suing as the mere puppet of a rival corporation. This constitutes a personal exception against his right to sue. Where the complainant sues bona fide in his own interest, and merely his motives are questionable, the action is generally held to lie. A similar prior suit brought by another stockholder and decided against him is *res adjudicata* (conclusive). Otherwise, there would be no end of litigation, and the court would be open to suit by every stockholder in the company, one after another, presenting the same old question over and over again for consideration. It is also a defense to show that plaintiff is not really a stockholder, as where his stock is fictitious or void.

209. **Same subject—Practical importance.**—The subject of stockholder's suits is very important today. It furnishes a remedy whereby the minority stockholder may obtain relief against oppressive acts on

the part of the directors or of the majority stockholders. Courts have nothing to do with the internal management of business corporations. The majority must govern. Corporations could be conducted upon no other basis. In corporations, however, as in republics, the majority must act fairly and must pay reasonable heed to the rights of the minority. They must not act illegally, fraudulently, or unjustly. If they so act, the strong arm of equity will restrain them.

210. **Powers of the majority.**—Very respectable authority asserts that the majority of the stockholders, as such, are not a trustee for the minority and do not stand in a fiduciary relation thereto.[26] On the other hand, it has been held in the United States Circuit Court of Appeals for the Kansas District that the holder of the majority of stock of a corporation cannot lawfully sell to himself for its fair value the entire property of the corporation, when he knows that this price is only five-sevenths of the amount which the corporation can obtain for it from somebody else. The sale was declared to be voidable at the election of the minority stockholders. And the modern authorities are strongly tending in this direction.[27]

[26] Windmuller v. Standard Distilling & Distributing Co., 114 Fed. 491.
[27] Wheeler v. Abilene Nat. Bk. Bldg. Co., 159 Fed. 391. See also Central Trust Co. v. Bridges, 57 Fed. 753 (per Taft, J.).

CHAPTER XIII.

CORPORATE CREDITORS.

211. **Relation between creditor and corporation.**—Creditors of corporations possess the same rights in general as the creditors of individuals, with the exception that corporate property impressed with a public use or employed in connection with some public duty cannot be taken on execution. The income, however, may be applied on the claims of creditors. The rule is well settled that creditors cannot interfere with the management of the corporation. They cannot interfere with the use or disposition of the corporate property, unless fraud or breach of trust is alleged and shown.[28] Thus, a bill in equity will not lie by a creditor to restrain the corporate debtor from making an alleged improvident contract. While creditors have no right to interfere in the corporate management, yet they may interfere to prevent threatened acts which would destroy their security; they may, for example, enjoin a waste of the corporate funds or have conveyances set aside which are fraudulent as to them. The creditor must first establish his claim in these cases by a judgment at law before a court of equity will afford him relief.

212. **Same subject—The trust fund theory.**—The so-called "trust fund doctrine" has caused much con-

[28] Pond v. Framingham & Lowell R. Co., 130 Mass. 194, LEADING ILLUSTRATIVE CASES.

fusion. Its origin is found in the case of Wood v. Dummer,[29] decided by Justice Story in 1835. He stated therein that the capital stock of a corporation is a trust fund for the benefit of the general creditors of the corporation, and must be dealt with as trust funds are dealt with. The case itself called for no such invention, the fact being that a bank divided up two-thirds of its capital among its stockholders without providing funds sufficient to pay its then outstanding billholders. Upon old and familiar principles, this was, of course, a gross and glaring fraud on creditors. All that the learned judge evidently meant by the doctrine was that corporate property must first be appropriated to the payment of the debts of the corporation before there can be any distribution of it among stockholders,—a rule that is sound upon the plainest principles of ordinary honesty. His expression was, however, hailed as a great discovery and has been dragged needlessly into the decisions. Thus, in New York, resort has been had to the trust fund doctrine in order to afford relief to a judgment creditor seeking to set aside a fraudulent conveyance by a debtor corporation of its property and assets.[30] Justice Finch, speaking for the Court of Appeals, said: "The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien, both as against the stockholders and all transferees, except those purchasing in good faith and for value." Such cases as this could be decided upon the most elementary principles in

[29] 3 Mason 308 (U. S.).

[30] Cole v. Millerton Iron Co., 133 N. Y. 164, LEADING ILLUSTRATIVE CASES.

the law of fraud. The law is needlessly complicated by dragging in the trust fund conception. It is absurd to say that there is a direct express trust attached to the property of a corporation. The famous case of Sawyer v. Hoag,[31] is responsible in a large measure for the confusion of judicial thought on this subject. In that case, a stockholder in an insurance company had given his promissory note for eighty-five per cent of his subscription to the stock of the company. After the company had become bankrupt, and the stockholder knew it, he bought up an outstanding claim against the company for one-third of its face value. In a suit by the assignee in bankruptcy of the corporation brought on his note, the stockholder set up this claim as an off-set. The Supreme Court of the United States declared "that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund." The same result could be reached without invoking that doctrine. There was, at least, a moral fraud committed.

213. **Same subject—Modern theory.**—The modern cases are tending to repudiate the idea that the corporate property is a trust fund for creditors. They say that the property of a corporation is a trust fund only in the same way, and to the same extent, that the property of an individual is a trust fund. A party may deal with a corporation in respect to its property in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or a lien. It is ridiculous to hold that

[31] 17 Wall. 610 (U. S.), 21 L. Ed. 731.

creditors, by virtue of their mere attitude as such, have any lien upon the actual tangible property of a corporation. Even in the United States Supreme Court, the trust fund doctrine is now confined to cases when a corporation is insolvent, and is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. Even then, there is not a true and complete trust, and it can be called so only "by way of analogy or metaphor." In truth, the property of a corporation is as much its absolute property as any man's property is his. "Solvent, it (the corporation) holds its property as any individual holds his, free from the touch of a creditor who has acquired no lien; free also from the touch of a stockholder who, though equitably interested in, has no legal right to, the property. Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, first for the creditors, and then for the stockholders. Whatever of trust there is, arises from the peculiar and diverse equitable rights of the stockholders as against the corporation in its property and their conditional liability to its creditors. It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder."[82]

The modern cases negative the idea of any direct trust or lien attaching to the property of a corpora-

[82] Hollins v. Brierfield Coal & Iron Co., 150 U. S. 371, 37 L. Ed. 1113.

tion in favor of its creditors. For example, X has taken common stock of a corporation without paying any consideration whatever either in property or money. Is it necessary to invoke the trust fund doctrine in order to hold him responsible to creditors? Not at all! Listen to the answer of Judge Mitchell in a learned opinion in a recent Minnesota case:[88] "But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of a corporation and the relation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid-in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, 'Make that representation good by paying for your stock.' It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can

[88] Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N. W. 1117.

fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of 'bonus' stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies into which the 'trust fund doctrine' has involved it; and we think that, even when the trust fund doctrine has been invoked, the decision in almost every well considered case is readily referable to such a rule."

214. **Relation between creditor and director.**—So long as a corporation is solvent and continues its business regularly, its directors are neither agents nor trustees of the creditors. But when it is insolvent, its creditors have a right to regard the directors as trustees or custodians of the corporate assets, for their benefit. In a loose sense, the assets become a trust fund in the hands of the trustees, that is, the directors.[34] While a corporation remains solvent, a director may, with the knowledge of the stockholders, deal with the corporation, loan it money, or buy property of it, just as a stranger. But the moment a corporation becomes insolvent, its directors occupy a different relation. A fiduciary relation then comes into existence between them and the creditors, and they are prohibited from purchasing the assets of their insolvent company or from securing a preference over other creditors.[35] In some jurisdictions, including Indiana, this is denied, and the courts hold

[34] Cassidy v. Uhlmann, 170 N. Y. 505, 63 N. E. 534.
[35] Beach v. Miller, 130 Ill. 162, 22 N. E. 464.

that no sufficient legal reason exists why the directors should be denied the right of preference in the event that the corporation becomes insolvent. These jurisdictions flatly deny that the director of an insolvent company is a trustee.

215. **Same subject—Statutory liability.**—Suppose a state statute provides that the officers and directors of a corporation shall be jointly and severally liable for all its debts if they make a certificate or report that shall be false in any material representation. Suppose a judgment is recovered under this statute in the state imposing the duty upon the director. Can this judgment be sued upon in another state? The answer to this question depends upon whether such a statute is to be considered penal in character. The United States Supreme Court has answered this in the negative.[36] It declared that the liability, though a penalty, was not such in the international sense, so that it could not be enforced in the courts of another state. The judgment of the Court of Appeals of Maryland, in deciding a case of this sort against the plaintiff, upon the ground that the judgment was not one which it was bound in any manner to enforce, was reversed for the reason that it denied to the judgment the full faith, credit, and effect to which it was entitled under the Constitution of the United States.

216. **Relation between creditor and stockholder.**—On principle, there is no trust relation between a creditor and a stockholder. There are many dicta to the contrary, but it is submitted that the above

[36] Huntington v. Attrill, 146 U. S. 657, 36 L. Ed. 1123.

statement is sound on principle. The two chief ways in which the liability of shareholders to creditors arises (apart from statute) are due to the failure of the stockholder to pay in full the amount of capital stock subscribed for by him, or to the payment to shareholders of dividends out of capital before paying the creditors. Ordinarily, the creditors' rights in these cases arise only after judgment has been obtained at law against the corporation, and execution has been returned unsatisfied, or partly so. Then the creditor has the right to sue the shareholders in equity to have the sums due the corporation paid in to satisfy his claim; he must usually bring a creditor's bill in such a way that the other creditors can come in and share in the proceeds in proportion to their claims.

A judgment against the corporation is conclusive as to the debt of the corporation, and an assessment against the shareholder by the court cannot be questioned by the shareholder; but he can contest his liability on the ground that he is not a member, or that the judgment was fraudulently obtained. A receiver is usually appointed in such cases by the court, who has authority to sue any shareholder in any state, who sues the corporation, to recover the amount so due; the liability of the shareholders is several, but it is usual in such a suit to join all, though some are out of the jurisdiction of the court.

217. **Same subject—Unpaid subscriptions.**—The unpaid stock subscriptions are to be regarded as a species of trust fund which the corporation holds for the payment of its debts. A plaintiff creditor who

sues to recover same is under no obligation to make all the stockholders parties defendant to his bill. It is not necessarily his duty to marshal the assets of the corporation or to adjust the equities between the stockholders. The courts say that for the protection of creditors, when necessary for their payment, the stockholders will be required to make payment of the balance due. This rests on the reasoning that it is in the nature of a fraud for the corporation and its stockholders to claim to have a capital stock up to a certain amount, which has never really been received in full. This is what is meant when the courts declare that such unpaid subscriptions are a trust fund for the security of creditors. A judgment creditor of a corporation may reach unpaid subscriptions, just as any judgment creditor of an individual may reach, in a creditor's bill, all debts due to his debtor.

218. **Same subject—Stock issued for money at less than par.**—In general, the rule stated in the preceding section applies to subscriptions where less than the par value in money is paid. However, when the corporation is in failing circumstances, but with the power to increase its stock, and it does this under stress of circumstances, and in good faith, to reëstablish itself, it may sell such stock at its market value, or issue it as bonus along with bonds issued to tide over its difficulties, and those who take the stock or bonds, or both, in good faith, at their market value, will not be held to any further liability in favor of subsequent creditors. A going concern, which finds its original capital impaired by loss or misfortune, may, for the purpose of recuperating itself, issue new

stock, put it upon the market, and sell it for the best price that can be obtained. So long as the transaction is bona fide, it will stand.[37]

219. **Same subject—Rights of prior and subsequent creditors.**—Only subsequent creditors, on principle, should be entitled to enforce their claims against stockholders whose subscriptions are not fully paid. They alone could have trusted the corporation upon the faith of the increased stock. Prior creditors could not have been misled and could not possibly have dealt with the corporation upon the strength of it. Only those who relied should have rights.

220. **Same subject—Stock issued for property.**—A corporation has a right to issue its stock for property. It cannot, however, be deemed to have the right to issue $100,000 worth of shares of capital stock against property reasonably worth only the price of a shoe string. Where shares of stock are issued in that manner, the holders thereof are liable to creditors of the corporation for the difference between what they paid for the stock and its par value. In some jurisdictions, recovery can only be had where full-paid stock is issued for property received, when the transaction is actually fraudulent; if there is no actual fraud, creditors cannot call the stockholders to account. "A gross and obvious over-valuation of property would be strong evidence of fraud."[38] In other jurisdictions, there must be established either intentional fraud in fact, or such reckless conduct in fixing the value of the property conveyed, without

[37] Handley v. Stutz, 139 U. S. 417, 35 L. Ed. 227.

[38] Coit v. N. Carolina Gold Amal. Co., 119 U. S. 343, 30 L. Ed. 420.

regard to its actual market value, that an intent to defraud may be inferred.[39] In still other jurisdictions, the "good faith" rule prevails. This means that if the parties have acted honestly and in good faith, mere over-valuation of the property given in exchange for stock will not render the stockholder liable. In a growing number of states the "true value" rule prevails. This means that, in general, the parties have the right in good faith to agree on the value of the property taken, but this should not be speculative or fictitious. "An honest mistake in judgment will not necessarily destroy the value agreed upon, but it must be such a valuation as a prudent and sensible business man would approve. A reasonable margin may be allowed for an honest difference of opinion, but a valuation grossly excessive is a fraud on creditors."[40]

221. **Same subject—Watered stock.**—Daniel Drew, who was a dealer in cattle before he became a stock market manipulator, is said to have actually watered his stock before selling them. It is said that he once cheated one of the Astors, then in the butcher business, by feeding his cattle on salt, getting them furiously thirsty, and then giving them water just before they were to be sold and weighed. Of course, the vendee paid for many a pound of water. Drew is said to have carried these methods into Wall Street. At any rate, we understand by "watered stock," stock that has no real value back of it. For example, where a corporation issues securities with a par value of

[39] Graves v. Brooks, 117 Mich. 424, 75 N. W. 932.
[40] State Trust Co. v. Turner, 111 Iowa 664, 82 N. W. 1029.

six hundred thousand dollars, but having actually behind them only one hundred and eighty thousand dollars in value, clearly the stock is watered and fictitious. As between the corporation and the stockholder, the agreement whereby the stock is issued for the property taken at an over-valuation is valid, but as against creditors, it is invalid and void, and the creditors can recover as for a fraud.[41]

222. **Same subject—Effect of notice on creditors' part.**—In Illinois it is held that the holder of "watered stock" is liable even to those creditors who extended credit to the corporation with knowledge that the stock was watered.[42] The general rule in this country is contrary, and declares that where the creditor deals with the corporation with full notice and knowledge of all the facts, he cannot recover. He cannot be heard to complain for the reason that no credit is given by him upon a representation of a different set of facts than those which actually existed.[43]

223. **Same subject—Statutory liability.**—The statutory liability, in the states where such has been created, of a stockholder to a creditor, is not in the nature of a penalty. Neither is it a consensual contract. It is more accurately a quasi-contractual obligation. Statutory liability is one imposed upon shareholders by special statute over and above their common-law liability, for the protection of creditors; it is not generally a part of the corporate funds for the

[41] New Castle N. R. Co. v. Simpson, 21 Fed. 533.
[42] Sprague v. Nat. Bk. of America, 172 Ill. 149, 50 N. E. 19.
[43] Bank v. Alden, 129 U. S. 372, 32 L. Ed. 725.
[43] Fort Madison Bank v. Alden, 129 U. S. 372, 32 L. Ed. 725.

purpose of carrying on its business, but it is rather a security for creditors alone. As to its legal character, this statutory liability is either: 1. Contractual, or 2. Penal.

The contractual statutory liability may be either: (a) A joint and several unlimited secondary liability; or (b) A joint and several unlimited liability; or (c) A limited primary and secondary liability. If *primary,* the liability arises at the time the liability of the corporation does; if *secondary,* it arises only after the corporation is unable to pay; if *unlimited,* it is substantially that of a partner; if *limited,* then it extends only to the limit fixed, which is usually a sum equal to the amount of the subscription, or such a proportion of the debts as the shareholder's shares are to the total shares. If it is primary, the Statute of Limitations would begin to run at the same time it does against the corporation; if secondary, only after it was established that the corporation could not pay. This liability may be provided in constitutional or statutory provisions; if it is provided for in the constitution, it will be self-executing whenever it is fixed in amount, and no special machinery is necessary for its enforcement.

A penalty is a punishment or fine provided for doing something that is forbidden, and is to be recovered by the state; it can be changed or modified at any time, and it is not enforcible outside of the state. Some of the statutory liabilities of shareholders are similar in form to penalties, but if they are designed for the protection of creditors in such a way that the offender becomes a debtor to the creditor by his fail-

ure, they are usually considered contractual in nature so as to allow suits to be brought in other states for their enforcement in favor of creditors. If the liability is contractual, subsequent creditors have a vested right to its enforcement for their protection, so that it could not be taken away without their consent; such a liability also survives and attaches to the estate of a deceased shareholder, and may be enforced against it; or the representative of a deceased creditor can enforce it against shareholders.

If a special remedy is provided, in the state creating the statutory liability, of such a kind that the right cannot be separated from the proceeding, and this is different from the proceeding in the state where it is sought to be enforced, it cannot be enforced in the other state at all; but if no special remedy is provided, and it is of a kind that can be enforced in a foreign jurisdiction by the ordinary procedure there, it may then be enforced in such foreign jurisdiction. The usual method of enforcing such statutory liability is by means of a creditor's bill and the appointment of a receiver.

224. **Same subject—Effect of transfer of shares.** —Under the English law, a stockholder may transfer his shares to an irresponsible or insolvent party for a nominal consideration, though the sole purpose of the transfer be to escape the liability of a stockholder under a statute; provided the transfer is out and out, and not merely colorable or collusive, with a secret trust attached. Under such circumstances, the person making the transfer is released from liability, both as to corporate creditors and other shareholders.

In this country the law is different, and the transferor of stock is not permitted to evade a statutory liability in this manner. For example, a stockholder in a national bank who is liable for the debts of the association to the extent of the par value of his shares, cannot transfer his stock if he knows, or should know, that the bank is insolvent. Notwithstanding this, the transfer would be valid if made to an individual of established financial responsibility, since the creditors could not suffer by the substitution of one solvent and reliable shareholder in place of another. In short, the question of liability is largely determined by the presence or absence of an intent to evade the double liability, or other liability imposed by statute.[44]

[44] McDonald v. Dewey, 202 U. S. 510, 50 L. Ed. 1128.

CHAPTER XIV.

DISSOLUTION OF CORPORATIONS.

225. **Methods.**—At common law it was said that a corporation could be dissolved (1) by act of Parliament, which was boundless in its operations, (2) by the natural death of all its members, in the case of an aggregate corporation, (3) by surrender of its franchises into the hands of the king, which was regarded as a sort of suicide, (4) by forfeiture of its charter because of negligence or abuse of its franchises. In this latter instance, the regular course pursued was to bring an information in the nature of a writ of quo warranto, to inquire by what warrant the shareholders were exercising corporate power, having forfeited it by such and such abuses.

Today the law is much changed on this topic. In England, where Parliament is without constitutional restraint upon its actions, corporations hold their franchises at its will. In this country, however, as we have seen, the legislative power is carefully limited by constitutional provision. The second method of dissolution does not apply today to business corporations. The shares are personal property and pass by assignment, bequest, or descent, and must always remain the property of some person. This is what we mean when we speak of the corporation as possessing immortality; its succession is perpetual. A corporation today cannot surrender its charter un-

less the government is willing to accept the surrender. Charters are regarded as compacts between the government and the incorporators. Just as the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the contract without the consent of the former. The surrender is of no avail until accepted. A corporation may today forfeit its charter by a misuse of its powers, yet this can only take effect upon a judgment of a competent court. Until a judicial decree is entered, the corporate existence continues.[45]

A corporation may also be dissolved today by the expiration of the time limit mentioned in its charter; by the happening of a condition or event prescribed by the charter to have that effect; or by a repeal of the corporate charter by the legislature when the state has reserved such power. Insolvency does not extinguish the legal existence of a corporation, nor does the omission to choose directors or officers necessarily have that effect.

226. **Same subject—Transfer of entire corporate property.**—The transfer of its entire property by a corporation does not result in the extinction of its legal existence. It has been held that an averment that a corporation paid all its liabilities, distributed its remaining assets among its stockholders, and has made no use since then of its franchises, falls far short of amounting to a dissolution as matter of law.[46] In a well-known Illinois case, where a corporation

[45] Boston Glass Manufactory v. Langdon, 24 Pick. 49 (Mass.), 35 Amer. Dec. 292, LEADING ILLUSTRATIVE CASES.

[46] Swan Land & Cattle Co. v. Frank, 148 U. S. 603, 37 L. Ed. 577.

transferred a hotel which was its sole property, the court said: "The effect of this transfer of all the hotel property no doubt was to terminate the business of the corporation; but that was not the necessary effect. It is entirely clear, upon the authorities, that the disposal of all the property of a corporation has not the effect to end or dissolve the corporation."[47]

227. **Forfeiture clauses in charters.**—Suppose that individuals are incorporated with a provision in the charter that if they do not commence business within five years, the corporate existence and powers shall cease. There has been much dispute among the authorities as to whether such a provision automatically executes itself or whether a judicial action must be undertaken in order to declare a forfeiture of the charter. In one New York case it was decided that, without legal proceedings, the existence of the corporation absolutely terminated; but in other cases the same court has held that where the legislature declares that, under certain conditions, the charter shall be null and void, the true meaning is that it shall be voidable, and an action by the attorney-general is necessary. In the last analysis, the question as to whether a forfeiture clause is or is not self-executing, depends wholly upon the language employed by the legislature.[48]

228. **Abuse or misuse of franchise.**—While an information in the nature of a quo warranto is recognized as the correct proceeding to test the right to exercise corporate functions and as the proper cor-

[47] Reichwald v. Commercial Hotel Co., 106 Ill. 439.

[48] New York & L. I. Bridge Co. v. Smith, 148 N. Y. 540, 42 N. E. 1088.

rective for misuses or non-user or abuses of the corporate franchises, yet it is not for the commission of every ultra vires act that a charter will be declared forfeited. The abuse must be gross, willful, continued, and related to the essence of the charter granted. It must also appear that the wrong complained of is of such a character that no adequate relief can be obtained in any other manner. Courts are averse to declaring forfeitures. Generally a breach of duty to the state must appear before the courts will act. Courts proceed with extreme caution in these proceedings, and are clothed with a very wide discretion. The test is, Does the interest of the public demand a judgment of corporate death?

Justice Finch of the Court of Appeals of New York makes this observation in an opinion: "The transgression must be not merely formal and incidental, but material and serious; and such as to harm or menace the public welfare. Corporations may, and often do, exceed their authority where only private rights are affected. When these are adjusted, all mischief ends and all harm is averted. But, where the transgression has a wider scope, and threatens the welfare of the people, they may summon the offender to answer for the abuse of its franchises or the violation of its corporate duty."[49]

229. **Jurisdiction of equity.**—In the absence of statutory authority, courts of equity possess no jurisdiction to decree a dissolution of a corporation by declaring a forfeiture of its franchise, either at the

[49] People v. North River Sugar Refining Co., 121 N. Y. 582, 24 N. E. 834.

suit of the state or of a private individual.[50] The mode of enforcing a forfeiture at common law was by scire facias or quo warranto in courts of law only at the suit of the sovereign. The assets were treated in the course of time as in the nature of a trust fund, to be administered for the benefit of the stockholders, subject first to the just claims of the corporate creditors. The necessity for invoking the aid of equity in administering these funds has led to statutory enactments vesting courts of equity with jurisdiction to decree dissolution of a corporation and wind up its affairs.

230. **Effect on corporate property.**—At the early common law it was held that, upon the death of a corporation, all its real estate reverted back to the original grantor and his heirs. The theory of this rested on the fanciful reason assigned by Coke, that a corporation could only take a qualified or base fee in realty. In other words, it was thought that the law annexed a condition to every grant of land to a corporation, that if the corporation should be dissolved, the donor or grantor might reënter. This "barbarous rule of the common law" is today nearly obsolete. Today, upon the dissolution of a corporation, the directors or managers at that time become the trustees of its property (in the absence of any other custodian) for the purpose of paying the debts of the corporation and dividing its surplus property, if any, among the stockholders. Consequently, where lands are conveyed absolutely to a stock corporation,

[50] Verplanck v. Merchants' Ins. Co., 1 Edw. Ch. 84 (N. Y.); Wheeler v. Pullman Iron & Steel Co., 142 Ill. 197, 32 N. E. 420.

no reversion or possibility of reverter remains in the grantor.[51] The old common-law rule, however, still applies to public or charitable corporations.

At common law, the personal property of a corporation escheated to the crown or state. Now it is preserved as an asset for the payment of the corporate creditors, or distribution among the stockholders after the corporate debts are paid.

231. **Same subject.**—At the early common law, all debts and choses in action, whether due to or from the corporation, became extinct. Thus, equity would enjoin the collection of notes made payable to a bank, the debtor being released by the dissolution. Today, such claims are preserved at law by statute. It would, of course, be ridiculous today to regard the debts of a corporation as totally extinguished by its dissolution. The effects of dissolution upon the corporate franchise are to prevent the further continuance of its exercise.

232. **Same subject—Corporate suits.**—At the common law, suits or actions by a corporation abated upon its dissolution; but by statute such a result is now prevented, by allowing the representatives of the defunct corporation to continue the actions in its place. At the common law, no valid judgment could be rendered against a dissolved corporation, and attachment and garnishment proceedings were terminated by a dissolution. Statutes now usually provide that dissolution shall not abate pending suits, nor prevent the bringing of suits against the defunct cor-

[51] Wilson v. Leary, 120 N. Car. 90, 26 S. E. 630. But see, State Bk. v. The State, 1 Blackf. 267 (Ind.), LEADING ILLUSTRATIVE CASES.

poration. Upon dissolution, either by voluntary surrender of the charter, by repeal, or by forfeiture, statutes usually provide either that the corporation shall itself continue to exist for a certain time in order to wind up its affairs, or that a receiver shall be appointed for such purpose.

In the well-known case of Sturges v. Vanderbilt,[52] it was decided that the dissolution of a corporation automatically terminates an action then pending against it, and that all subsequent proceedings against it are void, unless the action be continued by court order as provided by statute.

[52] 73 N. Y. 384.

CHAPTER XV.

FOREIGN CORPORATIONS.

233. **Status of national corporations.**—National corporations are not to be regarded as foreign corporations in any state, unless they are created to operate in one of the territories or in the District of Columbia, in which case they are regarded substantially the same as if created by the legislature of one of the states, Congress merely acting as the local legislature in one of these cases. But corporations created by the federal government to perform its national functions, to operate in any state, are not foreign corporations in any state. By the National Banking Act, a national bank located in any particular state is for most purposes treated as a citizen or inhabitant of that state; it, however, cannot be taxed in such state or the exercise of its powers restricted by the state where it is located, in any other way than as is expressly authorized by the national laws.

234. **Status of foreign corporations.**—It will be recalled that a corporation is not a citizen within the meaning of Article IV, § 2, of the Constitution of the United States, declaring that "The citizens of each state shall be entitled to all the immunities and privileges of citizens in the several states." It has been held, accordingly, that a corporation created by one state could exercise none of the privileges or functions conferred by its charter in any other state of the

United States, except by the comity and consent of the latter. Thus, a corporation organized in New York to manufacture and sell agricultural machinery has no vested or constitutional right to transact business in the state of Ohio. Ohio can either exclude the New York corporation altogether, or impose such restrictions upon the right of the New York corporation to do business in Ohio as it sees fit. Strictly speaking, the states of the Union are foreign to each other as regards most matters relating to corporation laws. The ownership of property, so long as it is legal, in any state, by a corporation organized in another state, is protected as is the property of an individual, so long as its acts within the state are legal, under the provisions of the Federal Constitution. A foreign corporation's right, however, to do business in any state is based upon mere comity, and cannot be claimed as a legal right. It has the power to do business anywhere, if not limited by its charter, but its right to do business in any other state than the one creating it depends upon the consent of the state where it seeks to do business. Even after the foreign state has granted a license to do business in the state to a corporation created elsewhere, the license may be revoked at any time, though a valuable consideration was paid for it, without violating any constitutional provision.[53] As said by Justice Hunt of the United States Supreme Court: "A license to a foreign corporation to enter a state does not involve a permanent right to remain. Subject

[53] Paul v. Virginia, 8 Wall. 168 (U. S.); Doyle v. Continental Ins. Co., 94 U. S. 535, LEADING ILLUSTRATIVE CASES.

to the laws and Constitution of the United States, full power and control over its territories, its citizens, and its business, belong to the state. If the state has the power to do an act, its intention or the reason by which it is influenced in doing it cannot be inquired into." The effect of the decisions is that a state may absolutely compel a foreign company to do or not to do certain acts; or, in the alternative, to cease to do business in the state. Thus, the state of Wisconsin may lawfully exact an agreement from a foreign insurance company, as a condition of issuing to it a license to do business in Wisconsin, that it will not remove any suit against it from the state court to the federal courts. It may compel the foreign company to abstain from the federal courts or to cease to do business in the state. It can give the company the option. This is justifiable, because the corporation has no constitutional right to do business in the state. The state has authority at any time to declare that it shall not do business within its borders.

235. **The rule of comity.**—It does not follow that because a corporation is without a constitutional right to do business in a state other than the state creating it, that it cannot do business in other states. It is permitted to do so under the principles of comity, that is, friendship between sovereign states. Under this rule of comity a foreign corporation can do business, subject only to certain restrictions. The foremost of these is that it can do no act in the foreign jurisdiction which it is unauthorized by its charter to do at home. The second is that it may not do any act which is contrary to any prohibitory law or to the

general public policy of the foreign state where the particular act is done.[54] Comity, in other words, permits a corporation to enter another state and do business therein, provided that it conforms with its own charter and with the public policy of that state. In Bank of Augusta v. Earle,[55] Chief Justice Taney said: "It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. But although it must live and have its being in that state only, yet it does not by any means follow that its existence there will not be recognized in other places; and its residence in one state creates no insuperable objection to its power of contracting in another. * * * Now, natural persons, through the intervention of agents, are continually making contracts in countries in which they do not reside, and where they are not personally present when the contract is made, and nobody has ever doubted the validity of these agreements. And what greater objection can there be to the capacity of an artificial person, by its agents, to make a contract within the scope of its limited powers in a sovereignty in which it does not reside, provided such contracts are permitted to be made by them by the laws of the place?" The learned justice, after stating that foreign corporations should be permitted to make such contracts, added: "It is but the usual comity of recognizing the law of another state."

236. **Methods of exclusion.**—In order to regulate and restrict foreign corporations doing business with-

[54] Cowell v. Springs Co., 100 U. S. 55, 25 L. Ed. 547.
[55] 13 Pet. 519 (U. S.).

in their boundaries, states usually provide: (1) That before doing business in a state a foreign corporation shall appoint some one within the state upon whom service of summons may be made. (2) That when the corporations of, say, state A are excluded by state B, then state A will exclude the corporations of state B, —these being called retaliatory laws. (3) That suits against such corporations shall not be removed by the corporations to the federal courts. While a provision of this kind cannot prevent the removal of a suit to the federal courts, the state, for a violation of the agreement, may exclude the foreign corporation that so offends from doing business within the state.

Certain penalties are usually provided for violating these provisions. Much controversy has arisen as to the validity of contracts made with the corporation that has failed to comply with them; the weight of authority probably is, that if a penalty is imposed either upon the offending corporation or its agent, that is the exclusive remedy, and the validity of the contract is not affected, and it may be enforced. This is particularly true when the complaining party, who seeks performance of the contract, is the person contracting with the corporation, since such a provision is specially designed for his protection. If the corporation is complainant, many cases hold it can enforce a contract made by it, before it complies with the provisions of the state law in reference to its doing business within the state; while other cases hold that if there is no penalty, and the corporation has not complied with the provisions, its contracts are void and unenforcible by either party to them,

until compliance has been made. This rule does not seem reasonable, so far as it applies to a contract which is sought to be enforced against the offending corporation. For a failure to comply, the state may, in either case, exclude the corporation.

The usual restrictions are imposed either in order to serve the corporation within the foreign state, e. g., by compelling it to appoint an agent there to receive service of process; or to compel the foreign corporation to place on file either with the Secretary of State or some other public officer, information which will enable people within the jurisdiction, dealing with the foreign corporation, to ascertain the extent of its powers. These restrictions, of course, apply only where the foreign corporations are actually "doing business" within the foreign state. A single, solitary act of business does not constitute "doing business" within the state. To be within the rule, the corporation "must transact within the state some substantial part of its ordinary business," and this must be not merely casual or occasional, but a continuous transaction of business.

237. **Right to engage in interstate commerce.**—While the general rule, as stated in the preceding sections, prevents a foreign corporation from entering and establishing a place of business and exercising its corporate franchises in another state, without its consent, yet any corporation, just as a natural person, under the Federal Constitution, has the right to engage in interstate commerce, and when so engaged it cannot be excluded or controlled by any state. There is some difficulty in determining just what constitutes

interstate or foreign commerce. But, in general, it includes buying and selling and transporting across state or national lines any commodity; or the traveling of any person; or the transmission of intelligence by telegraph or telephone across state lines. These things, constituting interstate commerce, cannot be prevented, hampered, or regulated by the states. A foreign corporation may make purchases through the mails, or it may send its traveling salesmen or solicitors into other states to make sales or purchases,—and if the goods are to be sent by the corporation to fill an order taken, or are to be sent to the corporation to fill a purchase made across state lines, this is interstate commerce. It has been held also that a ticket agent in one state, to solicit passengers over a certain line of railroad, not having any part of its road in that state, is engaged in interstate commerce. Interstate commerce, by the Federal Constitution, is given entirely over to federal control through Congress, and the state cannot interfere with it in any way. It is held that the business of insurance, or borrowing or loaning money, manufacturing, mining, farming, and the like, are not to be considered as commerce.

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LAW OF PARTNERSHIP

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CHAPTER I.

DEFINITION, CHARACTERISTICS AND TESTS OF A PARTNERSHIP.

1. **Sources of the law of partnership.**—Partnerships are of ancient origin. Under the Roman law a partnership was founded on confidence, independent of contract. The partners were usually relatives acting as mutual trustees for each other and shared the profits in proportion to the contribution made by each to the common fund. During the middle ages when trade was carried on under great difficulties partnership assumed its modern form. It was recognized as a contractual relation, but the necessity of trade generally confined partners to members of the same family and perpetuated the Roman principle of its being a confidential relation. The rules in regard to it were developed by the law merchant. The law merchant consisted of the general system of usages and customs in relation to commercial

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transactions observed alike among all merchants and commercial nations. These rules were for a long time enforced by committees of merchants appointed by the various mercantile associations and known as merchants' courts. Gradually, however, these courts ceased to be active, and controversies involving partnerships began during the eighteenth century to come into the ordinary courts of law. These law courts had long recognized joint ownership of property and were familiar with tenancies in common and joint tenancies. According to their rules, however, one co-owner of property bore no relation of confidence and trust to the other co-owners, and had no power to bind them by his action. Upon their conception of joint ownership of property they now engrafted the rules of the law merchant in regard to partnership.

2. **Confused state of the law.**—In engrafting the law of partnership on the common law, the English courts, however, did not follow every conclusion which had been reached by the Roman law and the law merchant. These systems of law had come to regard a partnership as an entity, or being, which was separate and distinct from the individual partners, in very much the same manner as a corporation is separate and distinct from its stockholders.[1] This conception did not fit into the view of joint ownership of the law courts and was probably for this reason rejected by them. According to the common law view, a partnership is nothing more than an association of individuals. A firm is recognized merely as

[1] See subject, CORPORATIONS. See § 17.

a convenient symbol or shorthand form for collectively designating all the partners. This view was not in accordance with mercantile views, and merchants continued to regard a firm as an entity. Courts of equity in certain cases also acted on the same principle. Statutes have been passed on this theory. Thus a conflict has resulted which has thrown the law of partnership into some confusion. Judges in deciding cases have either had the mercantile or the common law conception uppermost in their minds, and in consequence, have sometimes reached different conclusions on substantially the same states of fact. In the great majority of cases, however, it must be said, that either theory may be adopted without reaching different results.

3. **Same subject—Various conceptions of partnerships.**—Thus there are two theories of a partnership. According to one theory it is a separate entity very much like a corporation.[2] According to the other theory, it is a mere association of natural persons. These theories, however, are not the only ones that have been advanced. A learned writer on American law considers the partnership relation as a status very much like marriage is a status. "The sum of the rights and duties of the partners in the relation is called the status of partnership. The status may be created by contract like marriage or sale. The contract is the occasion or door and the consummation or conveyance establishes rights in rem."[3]

[2] See subject, CORPORATIONS.

[3] James Parsons, Principles of Partnership, p. 290.

4. **Definitions of partnership.**—In view of this confusion in the law of partnership, it is not surprising that an accurate, exclusive and inclusive definition of the relation has not been produced. A definition of partnership broad enough to embrace all cases, and narrow enough to exclude such as ought to be excluded, has been found a very difficult and embarrassing task to those writers who have published texts on the subject.[4] Numerous definitions have been attempted, but none of them are perfect. "The various definitions of a partnership have been approximate rather than exhaustive."[5] The following definitions of the relationship are submitted in order that the reader may obtain from all of them a general notion of what writers define to be a partnership.

Chancellor Kent defines a partnership as "a contract of two or more competent persons to place their money, effects, labor and skill or some or all of them in lawful commerce or business and to divide the profits and bear the losses in certain proportions."[6]

T. Parsons defines a partnership as "a combination by two or more persons of capital, or labor, or skill, for the purpose of business for their common benefit."[7]

Another definition is: "Partnership is a relation existing by virtue of a contract, express or implied, between persons carrying on a business owned in

[4] Tibbatts v. Tibbatts, 6 McLean 80 (U. S. Cir. Ct.).
[5] Meehan v. Valentine, 145 U. S. 611.
[6] 3 Kent, Commentaries, p. 23.
[7] T. Parsons, Partnership (2d ed.), p. 6.

common, with a view of profit to be shared by them."[8].

The relation has been defined by various statutes. Thus the English Partnership Act contains this definition: "A relation which subsists between persons carrying on a business in common with a view of profit."[9]

The Code of California defines it as "The association of two or more persons for the purpose of carrying on business together and dividing its profits between them."

5. **Same subject—Partnership an association.**—This implies that there are a number of persons interested in it. There must be at least two persons to form a partnership. If there is only one person interested in a business such business is not carried on as a partnership business, no matter what the name may be under which it is conducted. But the word association means more than this. It implies mutual consent of the associates. Without such mutual consent there can be no true partnership. But not every association founded upon mutual consent is, for that reason, a partnership. A church or social club is an association but it is not a partnership. It exists for purposes that are not commercial. A partnership, on the other hand, is formed for the purpose of trade or gain in business.[10] And this gain when realized must be the property of the associates, if they are to be treated as partners. If it belongs to

[8] Gilmore, Partnership, p. 1.

[9] 53 and 54 Vict. Ch. 39, par. 1 (English Partnership Act, 1890).

[10] Missouri Bottlers Assn. v. Fennerty, 81 Mo. App. 525; Burt v. Lathrop, 52 Mich. 106, LEADING ILLUSTRATIVE CASES.

somebody else and is not the property of the associates they can not be considered as partners.

6. **True partnership.**—What has been said in the previous sections applies to true partnership as distinguished from partnership by estoppel. A true partnership is a relation or a status which rests upon the express or implied understanding between the parties to it. Where there is no such understanding persons cannot be true partners, though they may be treated by the courts as if they were partners. A person may so conduct himself as to lead others into the belief that he and another person are partners. If innocent persons act on this belief and in consequence are put to a loss the person who has thus misled them will be held liable to the same extent as if he were a partner. He has acted in such a way that the courts will not permit him to escape a partnership liability though in fact he is not a true partner. Such a person will be held to be estopped to deny that he is a partner.[11]

7. **Partnership by operation of law.**—A true partnership, therefore, rests upon a contract or an agreement between the partners, while a partnership by estoppel means no more than that under certain circumstances a person who has represented himself as a partner and has thereby misled others will not be allowed to set up that he is not a partner.

Notwithstanding these plain and simple principles as to partnership, an exceptional relation known as "partnership as to third parties" for a while received general recognition by the courts. A person

[11] See § 31.

who shared in the profits of a business, though he had never agreed to be a partner, and though he had never misled anybody else into believing that he was a partner, was held to become liable as a partner. This rule was fully announced in Waugh v. Carver,[12] in which case it was held that persons participating in the profits of a business are as to third persons partners by operation of law. "He who takes a moiety of all profits indefinitely shall, by operation of law, be made liable to losses, if losses arise, upon the principle that, by taking a part of the profits, he takes from the creditors a part of that fund which is a proper security to them for the payment of their debts."[13]

The rule thus laid down by the courts is in conflict with the facts, for a creditor does not look to the profits of the business as a security for his debts. So long as there are debts there are no profits. While it therefore may be true that the creditor desires the business of his debtor to be profitable in order that his security may be ample, it matters nothing to him what becomes of the profits, provided the debts are paid.

8. **Exceptions to profit-sharing test.**—In applying the rule of Waugh v. Carver, the courts soon began to make a distinction between profits and gross returns. A mere clerk in a store receiving a salary will necessarily receive that salary out of the gross returns of the business. Yet, to hold him responsible as a partner would do violence to every

[12] 2 H. Bl. 235 (Eng.).

[13] Waugh v. Carver, 2 H. Bl. 235 (Eng.).

conception of right and justice. This is even so where, instead of receiving a salary out of the gross returns, a clerk or other employee receives a certain specified proportion of such gross returns as his compensation. The contract by which he shares in the profits of the business is merely a method of compensation for his services.[14] As long as he is simply allowed a fair compensation it is immaterial to the creditors whether he receives it in the form of wages or in the form of a commission.[15] There is no reason why a clerk who merely obeys orders and has no control over the business should be responsible for its debts which he could not prevent, merely because his compensation is contingent on the prosperity of the business.[16]

In limiting the application of the rule of Waugh v. Carver, the courts also soon began to distinguish between the sharing of profits as profits, and the rights to profits as a measure of compensation for services rendered or the use of property furnished. Where, therefore, the salary or wages of a workman are made dependent upon the profits realized through his endeavor, no partnership as to third persons was held to come into existence; so, also, may the owner of a threshing outfit lease the same to another for a season for one-half of the net profits without thereby becoming a partner of his lessee.[17]

Two exceptions to the rule, that there can be a partnership by operation of law as to third persons,

[14] Ellsworth v. Pomeroy, 26 Ind. 158.
[15] Blanchard v. Coolidge, 22 Pick. 151 (Mass.).
[16] Voorhees v. Jones, 29 N. J. L. 270, 272.
[17] Nofsinger v. Goldman, 122 Cal. 609, 55 Pac. 423.

thus grew up and became well established: (1) Those who share gross returns, as distinguished from net profits, are not necessarily partners as to third persons. (2) A reference to profits as a measure of compensation for services rendered or for the use of property furnished does not create a partnership as to third persons.[18]

9. **The doctrine of Waugh v. Carver over-thrown.**—The rule of Waugh v. Carver was the law in England until the year 1860, when it was over-thrown in the leading case, Cox v. Hickman,[19] in which case the House of Lords, the highest English court, held that creditors of an insolvent merchant who had made an agreement with the merchant, according to which he was to turn over the management of the business to a committee of the creditors who were to pay the profits realized to the various creditors until all their debts were paid, did not thereby become partners of the insolvent and of the members of the committee. This case has since that time been followed in England and by many jurisdictions in the United States. There are, however, some states in the United States in which the rule of Waugh v. Carver had become so firmly established that courts did not feel at liberty to break away from it.[20]

10. **Mutual agency as a test of partnership.**—The case of Cox v. Hickman, mentioned above, has sometimes been cited as supporting the proposition that mutual agency is a test of partnership, and it must

[18] Leggett v. Hyde, 58 N. Y. 272, LEADING ILLUSTRATIVE CASES.

[19] 8 H. L. Cas. 268 (Eng.).

[20] Beecher v. Bush, 45 Mich. 188, 7 N. W. 785, LEADING ILLUSTRATIVE CASES. See also note in 18 L. R. A. (N. S.) 963.

It sometimes happens that persons enter into a mutual relation without in terms expressing an intention to become partners. Or they may use the word partner in a broad and popular sense without in fact intending to enter what the law defines as a partnership relation. Or they may cover up their real intentions under ambiguous words. In all such cases the courts will inquire what the actual relationship was which was intended. The question whether or not that relationship is a partnership becomes thereafter a question of law. The parties must have intended their acts but the consequence of these acts are determined by the law. It is "possible for parties to intend no partnership and yet to form one. If they agree upon an arrangement which is a partnership in fact, it is of no importance that they call it something else, or that they even expressly declare that they are not to be partners. The law must declare what is the legal import of their agreement."[24]

14. **How intention is ascertained.**—The court or jury in ascertaining whether the parties to a contract intend to become partners, will take into consideration the whole situation existing at the time of the agreement and all the circumstances surrounding the transaction, as well as the subsequent actions and admissions of the parties. Where the agreement is in writing, the writing will be construed by the courts in the light of these circumstances and will govern the case. The name by which the parties have styled their relation will not neces-

[24] Beecher v. Bush, 45 Mich. 188, 7 N. W. 785, LEADING ILLUSTRATIVE CASES.

sarily be decisive, though it will have great weight, especially in doubtful cases. "It is not essential to the existence of a partnership that it be so denominated in the contract of the parties, nor is it necessarily fatal thereto if the parties declare in such contract that they do not intend to become partners."[25]

Such declaration may be interpreted as merely showing that they have mistaken the legal effect of the agreement which they have made. Even where the parties expressly deny that they intend to create a partnership, they are nevertheless bound as partners if the legal effect of their acts and contracts is to constitute a partnership. Deeds speak louder than words. The mere expression or lack of expression of their intention is not as powerful as the legal effect of their conduct. Where A and B agree with C that each is to contribute a certain proportion of capital and that C is to buy potatoes and ship them to A and B who are to sell them, the profits to be divided at the end of the season in proportion to the capital furnished by each, A, B and C become partners, even though nothing is said as to partnership in the agreement, and even though they did not suppose that they were entering into a partnership.[26]

On the other hand where A sells to B a one-half interest in a horse, and it is provided in the agreement that B is to keep the horse for eighteen months and that "the partners" A and B are to pay an equal portion of the expenses of the horse during that time, no partnership comes into existence, as the nature

[25] Spaulding v. Stubbings, 86 Wis. 255, 262.
[26] Duryea v. Whitcomb, 31 Vt. 395.

and terms of the agreement clearly show that A and B are merely part owners.[27]

15. **Tests of intention.**—Where an agreement contains all the elements necessary to create a partnership the intention of the parties is clear and no test to determine that intention need be applied. Where, however, an agreement contains only part of these elements it becomes important to ascertain the intention of the parties, and in ascertaining such intention the legal tests of the same must be properly applied.

An agreement to share the profits of a business is presumptive evidence of an intent to form a partnership. Where persons enter into an agreement for a joint venture and agree to share the profits, a presumption will arise that they intend to be partners, and evidence will have to be introduced to show that such was not their intention. If no such evidence is introduced the presumption will prevail. Such presumption is still stronger where parties to a contract agree to share both profits and losses. A person will hardly ever agree to share the losses of a business unless they are principals. A different rule, however, applies where contracting parties agree merely to share the gross returns of the business. "The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common interest in any property from which or from the use of which the returns are derived."[28]

[27] Oliver v. Gray, 4 Ark. 425.

[28] English Partnership Act, 1890, par. 2 (2).

It has sometimes been asserted that mutual agency is a test of the intention to become a partner. This is a mistaken notion. Persons are mutual agents because they are partners. They are not partners merely because they are mutual agents. Persons may be mutual agents without being partners, but on the other hand they may even be partners without being mutual agents. "The reference to agency as a test of partnership was unfortunate and inconclusive inasmuch as agency results from partnership rather than partnership from agency."[29]

16. **Partnership distinguished from other relations.**—It is not always an easy task to distinguish partnership from other relations. The lines which divide partnership from other joint ownerships[30] are sometimes very fine and shadowy and it is quite difficult to make them out clearly. "The books are full of nice distinctions and definitions showing that it is often difficult to decide to which class the particular facts and circumstances assign cases."[31] The relations which bear the closest analogy to partnerships are corporations, voluntary associations and joint ownerships.

17. **Same subject—Corporations.**—According to the mercantile view, a partnership is a separate entity just like a corporation. According to the common law view, no such analogy exists, and the analogy stops at this point, even according to the mercantile view of partnerships. In every other re-

[29] Meehan v. Valentine, 145 U. S. 611. See § 10.
[30] For a definition of joint ownership, see § 11.
[31] Sodiker v. Applegate, 24 W. Va. 411.

spect a corporation and a partnership are widely different. A corporation requires as a prerequisite of existence a charter from the government, while a partnership comes into being through the mere agreement of the partners. The liability of a stockholder in a corporation is limited, while a partner is liable for the entire debts of the partnership. The withdrawal of a partner instantly dissolves a firm, while shares of stock in a corporation may pass from hand to hand, like bills and notes, without affecting the existence of the corporation in the least. A corporation may sue and be sued in its corporate name, while a partnership in the absence of statute, must sue and be sued in the names of the persons composing it.[32]

18. **Same subject—Voluntary associations.**—A voluntary association has been defined as a body of persons acting together without a charter but upon the methods and forms used by incorporate bodies for the prosecution of some common enterprise. Perhaps the most common form of such associations is that of unincorporated church societies. Such societies are formed for the spiritual uplift and betterment of their members and not for the purpose of making profit. Hence the courts have universally held that such societies are not partnerships,[33] though a different view is taken in Georgia.[34]

The same principles are applied to social clubs, and societies for civic, literary, athletic or other similar non-profit making purposes. Even a committee

[32] See subject, CORPORATIONS.

[33] Schradi v. Dornfeld, 52 Minn. 465, 55 N. W. 49.

[34] Thurmond v. Cedar Spring Baptist Church, 110 Ga. 816, 36 S. E. 221.

of thirteen appointed by the Whigs of Pittsburg to arrange for a dinner in celebration of Harrison's victory in 1840, at which dinner 4,000 people partook "with wonderful cordiality," was not a partnership, though its members were liable on other grounds for the bill thus contracted.[35]

19. **Same subject — Joint ownership.** — Two or more persons jointly interested in land or goods, or both, may or may not be partners.[36] If they associate themselves for the purpose of conducting a business and sharing the profits with their common property as a basis, they will become partners and will be subject to all the liabilities of the relation. If, however, they stop short of this, no partnership relation will come into existence. Thus two part owners of a ship are not necessarily partners, though the vessel goes out on various voyages under the management of one of them.[37]

This is especially so where land is held in joint ownership. Originally land was not a subject of merchandising. It would pass from ancestor to heir but was not ordinarily thrown into the market. For a time such joint ownership could not form the basis of a partnership. This time has now passed. But courts still require stronger proof that joint or common owners of land are partners, than is required where chattels are the subject matter of co-proprietorship. "From its nature, and the legal requirement in regard to conveying title to it, real

[35] Ash v. Guie, 97 Pa. St. 493.

[36] For definition of joint ownership see § 11.

[37] Helme v. Smith, 7 Bing. 709 (Eng.).

estate alone has rarely been the sole subject matter of a partnership. * * * From the nature of the property, the limitations of the agency of each partner in making a perfected sale, courts are not inclined to imply a partnership where the subject matter is real estate alone."[38]

Thus it has been held that two persons who buy a mill site and jointly contract with a builder for the erection of a sawmill thereon are tenants in common and not partners.[39] But if they should carry on a milling business owned in common, they would be partners.[40]

[38] Farrand v. Gleason, 56 Vt. 633.
[39] Porter v. McClure & Tourtellot, 15 Wend. 187 (N. Y.).
[40] Noyes v. Cushman, 25 Vt. 390.

CHAPTER II.

CREATION OF A PARTNERSHIP.

20. **Partnership rests on contract.**—A partnership does not derive its life by charter from the state, as does a corporation. Neither does it arise by implication or operation of law through the mere fact of profit sharing, though this was at one time an established doctrine in England and is still held as law by some American courts.[41] The intention or even the belief of one party cannot create it without the assent of the other parties. The courts will not surprise people into a partnership of which they never dreamed. Thus, where a man immigrates from Scotland and gradually builds up a large manufacturing plant and his sons assist him in this work until they are men of middle age, but without ever making any partnership agreement, no partnership arises.[42]

It would be unjust to force people against their will into a partnership, for a partnership relation is inherently a relation of the most implicit confidence. "When a man enters into a partnership he certainly commits his dearest rights to the discretion of every one who forms a part of that partnership."[43]

Hence, partnership rests, and must necessarily rest, on mutual consent, or in other words, on contract. It can exist only in pursuance of an expressed

[41] See § 7.

[42] Phillips v. Phillips, 49 Ill. 437, LEADING ILLUSTRATIVE CASES.

[43] Wells v. Masterman, 2 Esp. 731 (Eng.).

or implied agreement to which the minds of all parties have assented. Thus where A, B, C, D and E are in partnership, A and B cannot, without the assent of C, D and E, admit another party, F, into the partnership.[44]

21. **The partnership contract may be implied.**—Unless a partnership contract is governed by the Statute of Frauds[45] no formality will be required in connection with it. All that is necessary to make A and B partners is that they have reached an agreement between themselves to carry on a common business and to divide the profits. This agreement is generally reduced to writing but it may rest merely on conversations, and may even be deduced merely from the actions of the parties without any written or spoken agreement.

Suppose that A and B inherit a business from their father. They continue it at the old stand under the old name. Every week or oftener each of them draws out the same amount of money. Likewise, they borrow money and invest it in the business. Under these circumstances they will be held to be partners, although as a matter of fact they have never entered into any express agreement to that effect.[46]

22. **Contract governed by the Statute of Frauds.**—In 1677 the English Parliament passed the Statute of Frauds. This Statute provides that no action shall be maintained on certain contracts unless there shall

[44] Burnett v. Snyder, 76 N. Y. 344.
[45] See § 22.
[46] Davis v. Davis [1894], 1 Ch. 393 (Eng.).

have been executed a note or memorandum in writing signed by the party to be charged. The object was to prevent frauds and perjuries which it was believed would be perpetrated if reliance in proving such contracts was placed upon the mere recollection of witnesses. This Statute has been quite generally adopted in the United States. Among other things, it makes contracts for the sale of land, or any interest therein, void unless they are evidenced by some writing.

The question has arisen whether a partnership formed for the purpose of dealing in real estate is within this provision. The answer to this question will depend upon the further question whether the land in question was at the time of the partnership agreement owned by the partners or whether it was to be acquired later.

Suppose that A owns one lot and that B owns another. They verbally agree to form a partnership for the sale of both lots. They succeed in selling both lots, but the profit made on A's lot is greater than that made on B's lot. B, however, cannot force A to divide the profit, since their partnership agreement was not reduced to writing, because to allow B to take the profit from A's lot would give him an interest in this lot, which interest, according to the Statute of Frauds, can only be acquired by a contract reduced to writing.[47]

A different question, however, arises where a partnership firm is founded for the purpose of buying and selling real estate. When the parties enter into

[47] Burney v. Savannah Grocery Co., 98 Ga. 711, 25 S. E. 915.

a verbal agreement to speculate in lands, it is apparent that no estate or interest in lands is granted or assigned or declared. The partners do not even acquire any interest in lands. "A partnership agreement between A and B that they shall be jointly interested in a speculation for buying, improving for sale and selling lands, may be proved without being evidenced by any writing, * * * and such an agreement being proved, A and B may establish his interest in land, the subject of the partnership, without such interest being evidenced by any such writing."[48]

A further situation may arise where a partnership is formed for the purpose of conducting a general mercantile business. In the course of its operations the partnership acquires real estate, or it invests some of its earnings in real land. Often the title to the land stands in the name of one of the partners. In such a case most courts permit the introduction of oral evidence to be used to prove the interest of all of the partners in this land.

The result is to be explained in this way: Partnership is a relation resulting from contract, and whether there is such a contract is a question of fact, which may be proved by oral evidence. Having thus established the existence of a partnership, oral evidence may then be used to show what constitutes the property of such firm, and the interests of the partners therein. The oral evidence is proper even though a part of the property of the firm consists of land.

[48] Dale v. Hamilton, 5 Hare 369 (Eng.); Chester v. Dickerson, 54 N. Y. 1.

The authorities on the question of this section are conflicting and in some confusion. By the weight of authority, however, the Statute does not apply to partnership contracts, except possibly in a case like the one first mentioned above.

23. **Who can be partners.**—Like every other contract, a partnership agreement requires parties who are competent to contract. An agreement implies the action of at least two minds who are capable of forming conclusions. It implies that these two minds must meet on some proposition. If for any reason these minds do not meet, no agreement can come into existence. But even where there is sufficient mind in both parties, and even where these minds have met, there may be legal or physical obstacles which will prevent a valid contract.

Suppose that a man and a woman are within the prohibited degrees of relationship, or that one of them is already married; although the parties are of one mind, yet no valid agreement for a marriage can be made between them, for there are legal obstacles which prevent the creation of a contract to marry. The same reasoning holds good in regard to partnership agreements. Unless the parties to the agreement are competent to make such an agreement, no partnership can arise. Obstacles arising in the way of a partnership agreement may be the fact that one of the proposed partners is an infant, a lunatic, an alien, a corporation or even a married woman.

24. **Same subject—Infants.**—All contracts of infants may be avoided by them on becoming of age, except contracts for necessaries. Necessaries are

such articles of food, clothing and shelter as are appropriate to the station in life of the infant. What are necessaries for the son of a millionaire may not be necessaries in the case of a laboring man's son. Articles bought for the purpose of trade are not necessaries for a minor. An infant is not bound by a contract for a barber's chair, although the trade of a barber is his only means of support.[49] It follows that an infant partner is not bound by a contract for such articles whether this contract is made directly by him or by one of his copartners. On becoming of age he may repudiate it and throw the burden of meeting it on his copartners. He may even repudiate the partnership contract itself, or violate it with impunity. His partners cannot bind him by contract, while he on the other hand may make contracts which will bind them. Hence it is not good policy to enter into a partnership with a minor.

A minor may, however, on becoming of age, ratify the contract made by him. If he does this, the contract will become binding upon him the same as if it had been made after he became of age. It is not necessary that this ratification be executed in any formal manner. It need not be in writing but may even be implied from his mere non-action. Furthermore, if within a reasonable time after he reaches his majority he does not return articles purchased by him, provided they are still in his possession, he will be held to have ratified the contract for their purchase.

[49] Ryan v. Smith, 165 Mass. 303.

But where an infant has invested money in a partnership venture he cannot withdraw it to the prejudice of the creditors of the partnership. His copartners in such a case are "entitled to insist that the partnership assets shall be applied in payment of the liabilities of the partnership and that until these are provided for, no part of them shall be received by the infant partner, and if the proper steps are taken this right of the adult partner can be made available for the benefit of the firm creditors."[50]

25. **Same subject—Lunatics and aliens.**—A lunatic is very much in the same position as an infant. His contracts are generally held to be voidable, although there are some states in which they are held to be void. It follows that on recovering his reason he may repudiate contracts made by him during his insanity or may ratify them. Since, however, it is not as easy to detect lunacy in some cases as it is to detect infancy, cases may arise where the lunatic will be bound on a contract made by him, provided the person with whom the contract was made has acted in good faith. To the extent to which a lunatic may enter into a contract, he may also enter into a partnership agreement. Of course, it is obvious that such an arrangement will not be a very beneficial one to the other partners.

It sometimes happens that a partner becomes insane during the continuance of the partnership relation. In such cases courts will dissolve the partnership at the request of the other partners. Until such dissolution the lunatic is entitled to a share

[50] Lovell v. Beauchamp [1894], A. C. 607, 611 (Eng.).

of the profits made by the other partners and is liable for their misconduct.[51]

In considering the question whether an alien can be a partner it becomes necessary to distinguish between an alien friend and an alien enemy. If A lives in America and B in England, A and B are alien friends, so long as the two nations are at peace. As soon as war breaks out between England and America, they become alien enemies. While the two countries are at peace a partnership may be made between A and B. However, after war has broken out such partnership becomes illegal and cannot be contracted. Even where A and B are in partnership before the war breaks out this partnership will be dissolved without any action on their part by the mere declaration of war.[52]

26. **Same subject—Married women.**—Under the old English law, a married woman was deprived of practically all civil rights. Her person was said to be merged in that of her husband. A husband and wife were said to be one. On marriage, the husband assumed all of his wife's property and also all her debts. Thereafter she could not sue or be sued in her own name, not even if a personal injury was inflicted on her. She could not bind herself by any contract nor was she liable for any wrong which she had committed. It followed that she could not enter into a partnership agreement, and hence could not be a partner.

These disabilities have generally been removed by

[51] Raymond v. Vaughan, 128 Ill. 256, 21 N. E. 566.
[52] Griswold v. Waddington, 15 Johns. 57 (N. Y.).

married women's acts in most, if not all, states. The married woman has generally been given the right of binding herself by contract. She has been given the management of her own separate estate or business. It follows that she is now free to enter into a partnership with anyone except her own husband.

Some states will even allow her to enter into partnership with her husband. The weight of authority is to the contrary. Courts in denying her this right proceed on the theory of protecting her against her own husband. They reason that an improvident husband might take advantage of a wife who has property and force her into a partnership with him in order to be able to waste and dissipate her estate.[58]

27. **Same subject—Corporations.**—The charter of a corporation may expressly authorize it to enter into a partnership relation with other corporations, or with natural persons. If no such authority has been given the corporation will not have power to enter into any such arrangement. To allow such powerful corporations as the Standard Oil Company and the International Harvester Company to enter into partnership with each other, or with other equally powerful corporations, might legalize a most pernicious form of trust organization.

28. **The partnership agreement must rest on a consideration.**—It is a familiar principle of the English law, as distinguished from the Roman law, that an agreement to be a valid contract, must involve a consideration. This principle applies to partnership contracts the same as to any other contract. The

[58] Board of Trade v. Hayden, 4 Wash. 263, 30 Pac. 87, 32 Pac. 224.

consideration may take the form of a benefit or a detriment, but it must be present in some form. Without a consideration an agreement is void, and will not be enforced by the courts. Where, therefore, a person is to share equally in the firm property or its profits, without doing anything whatsoever toward the common enterprise, the agreement is unenforcible.[54] But this consideration, on the other hand, need not consist of money or other tangible objects. The mutual promises of the partners to contribute capital, services or credit to the common enterprise, will constitute a sufficient consideration. Any liability, contingent or otherwise, large or small, assumed by the parties will serve the same purpose. Nor need the contribution of each be equal to that of the others. "If one man has skill and wants capital to make that skill available, and another has capital and wants skill, and the two agree that the one shall provide the capital and the other skill, it is perfectly clear that there is a good consideration, for the agreement on both sides; and it is impossible for the courts to measure the quantum of value. The parties must decide that for themselves."[55]

29. **The contract must not be illegal.**—The agreement on which a partnership is founded must in itself be a legal and enforcible contract. It must not be in violation of any positive law or in opposition to public policy. A partnership for the purpose of smuggling or gambling would be void and no court would enforce it. It is familiar law that the courts will

[54] Trayes v. Johns, 11 Colo. App. 219.
[55] Dale v. Hamilton, 5 Hare 369 (Eng.).

leave the parties to such contracts exactly where they find them, and will refuse to aid either of them. "Two men enter into a conspiracy to rob on the highway, and they do rob, and while one is holding the traveler, the other rifles his pocket of $1,000, and then refuses to divide and the other files a bill to settle up the partnership. They go into all the wicked details of the conspiracy and the rencounter of the treachery. Will a court of justice hear them? No case can be found where a court has allowed itself to be so abased.[56]

This illegality, however, must affect the contract on which the plaintiff relies. Thus, in the cited case of the two robbers: "If the robbers had taken the $1,000 and invested it in some legitimate business as partners, and had afterwards sought the aid of the court to settle up that legitimate business, the court would not have gone back to inquire how they first got the money. That would have been a past transaction not necessary to be mentioned in the settlement of the new business."

30. **The contract must be carried out.**—A contract to form a partnership at a future time is very much like an agreement to marry. It may result in a partnership but it does not of itself create a partnership. In order to create a partnership relation, it must be executed. Something must be done to carry out the agreement and launch the partnership. Until the agreement has been acted upon the partnership has not come into being. "Unless something is done, or unless the agreement from its nature

[56] King v. Winants, 71 N. C. 469, 473.

operates *in praesenti,* the contract is executory, and either party may decline to carry it out, though liable it may be to a bill for specific performance or for damages at law in proper cases."[57] To illustrate: A contract between two persons according to which either of them is to buy certain machinery and the other by assenting to such purchase, is to become entitled to the profits realized from the same, is not an executed partnership agreement, but is at best, an agreement between them to form a partnership at a future time.

31. **Partnership by holding out—Estoppel.**—Persons may be held liable as though they were partners although in fact no partnership exists. Suppose A and B were at one time in partnership but have since dissolved. B has continued the business under the old name of A and B. C, believing that the old firm is still in existence, extends credit to B. B becomes bankrupt. Obviously it would be unjust to allow A to escape liability for the debt contracted by B on the ground that B was not actually a partner of A. A has allowed B to hold him out as a partner, and C has extended credit to B relying on such holding out. It follows that A must make good the loss of C as if he were a partner of B. If A had not permitted B to hold him out as a partner, even though B had actually done so, C could not hold A, because the act of B could not be imputed to A.

On the other hand, if C had not known of the apparent partnership between A and B but had simply extended credit to B, he could not hold A because A

[57] Sabel v. Savannah Rail & Equipment Co., 135 Ala. 380, 33 So. 663.

would not have misled him. "No person can be fixed with liability on the ground that he has been held out as a partner unless two things concur, viz.: first, the alleged act of holding out must have been done either by him or by his consent, and secondly, it must have been known to the person seeking to avail himself of it. In the absence of the first of these requisites, whatever may have been done, cannot be imputed to the person sought to be made liable, and in the absence of the second, the person seeking to make him liable has not in any way been misled."[58] As the liability of A "rests solely upon the ground that he cannot be permitted to deny a participation, which though not existing in fact, he has asserted or permitted to appear to exist, there is no reason why a creditor of the partnership who has neither known of nor acted upon the assertion or permissions, should hold as a partner one who never was in fact, and whom he never understood or supposed to be a partner at the time of dealing with and giving credit to the partnership."[59] A person who thus holds himself out as a partner is said to be estopped to deny that he is a partner as against a third person who has extended credit on the faith of the representations. This doctrine of estoppel is not in conflict with the rule that a partnership rests on agreement of the parties. It does not create a partnership. It merely prevents a person who has held himself out as a partner from defeating the just claims of creditors.

[58] Lindley, Partnership (5th ed.), p. 55.

[59] Thompson v. First National Bank of Toledo, 111 U. S. 529.

32. **Partnership liability of stockholder in defective corporation.**—Corporations are classified into de jure and de facto corporations. A de jure corporation comes into existence upon the substantial compliance with the law under which its incorporation can be effected. After such incorporation it has legal existence and can maintain its legal existence even as against the state which created it. The liability of its stockholders is simply that prescribed by the law under which it is organized.

A corporation de facto, on the other hand, if not illegal, is at least illegitimate. It will have to be recognized, however, by all persons except the state which may terminate its existence by direct proceeding for that purpose. To create a de facto corporation there must be a law under which a de jure corporation could have been organized, an attempt in good faith to incorporate under such a law, some compliance with the law and the subsequent user of corporation rights. The question of the liability of stockholders in such a corporation is an important and disputed one. Some courts hold them to a partnership liability, reasoning that they have contracted for all the benefits of a partnership and that in order to escape the liabilities of a partnership they should have obeyed the requirements of the statute under which they attempted to incorporate.[60] Other cases, however, argue that such stockholders never intended to form a partnership, and ought not to be held to a partnership liability.[61]

[60] Bigelow v. Gregory, 73 Ill. 197.

[61] Rutherford v. Hill, 22 Or. 218, 29 Pac. 546.

Where, however, a number of individuals merely pretend to act as a corporation and to exercise corporate powers no corporation de facto will come into existence. The persons conducting business under such a pretense will therefore be held liable as partners.[62]

If persons attempt to organize a corporation for a purpose not covered by the statute under which they pretend to act, they will be held to a partnership liability. Thus, the members of a rifle club organized under a statute permitting incorporation for "literary, scientific and charitable purposes" will be individually liable to the widow of a person killed by a bear kept by the club.[63]

[62] Fuller v. Rowe, 57 N. Y. 23.
[63] Vredenburg v. Behan, 33 La. Ann. 627.

CHAPTER III.

THE NAME AND PROPERTY OF A PARTNERSHIP.

33. **Name of firm.**—A firm name is not essential to a partnership. The partners may do without it and may carry on business in their individual names. A firm name, however, will be found expedient in almost all cases. It is a convenient symbol to designate all the partners collectively. The use of it shows that the transaction with which it is connected was intended to be a partnership and not an individual transaction. The range of choice which partners have in selecting a name is practically unlimited. Suppose John Smith intends to begin business with his son Henry. The partnership may be called Smith and Smith, or John Smith and Henry Smith, or J. and H. Smith. If the partners prefer, they may put the name of only one of the partners into the partnership name and refer to the other partner. They may call the partnership Smith & Son, or John Smith and Son, or Henry Smith and Father. Business men sometimes even go further than this. They put the name of one partner into the partnership name and cover all the other partners by the word "company." In the present case the firm name might be Smith and Co., or John Smith and Company, or Henry Smith and Company. The partners may even avoid any reference to their individual names and may give the partnership a purely fanci-

ful name, such as the "Union Towing Co."[64] No exclusive right can be obtained in a partnership name. Persons trading under the name of "Rogers and Bro." cannot complain because others trade under the name of "C. Rogers & Bros.," provided this is done in an honest and ordinary business way.[65] Even more than one name may be adopted by one partnership. Lewis, Gorthwaite & Grant may trade in New York under the name of Lewis, Gorthwaite and Co., and in New Orleans under the name of Grant, Lewis and Co., and all will be liable for notes executed under either of these names.[66] Some states, however, have adopted statutes by which the choice of partnership names is limited. Some of these statutes forbid the addition of the word "company" to a name or names unless there is an actual partner represented thereby. Still other statutes forbid the use of a name such as the Union Towing Company because this is applicable to a corporation and may mislead persons who deal with it. Still other statutes require firms doing business under a fanciful name to file certificates in a certain office stating the names of the actual partners.

34. **Firm name in business transactions.**—Whenever a partnership has adopted a name this should be used in all business transactions involving personal property. The use of this name will raise a presumption that a partnership exists and that the transaction is a firm affair. "The business of the

[64] Crawford v. Collins, 45 Barb. 269 (N. Y.); Haskins v. D'Este, 133 Mass. 356, LEADING ILLUSTRATIVE CASES.

[65] Rogers v. Rogers, 53 Conn. 121.

[66] Messner v. Lewis, 20 Tex. 221.

country is largely carried on by partners under partnership names which frequently do not contain the name of any person. Vast quantities of personal property of all kinds are contracted for, bought and sold by such firms under their firm names each year and their right to thus buy and sell goes unchallenged."[67] Hence a chattel mortgage may be taken in the firm name. The transfer of property rights in personal property by the firm name is universally recognized.

Where, however, a conveyance of real estate is made by or to the members of a partnership a different rule applies. Real estate is conveyed usually by an instrument under seal. As to such instruments it is the general rule that only such parties as are expressly named will be recognized. A conveyance of real estate should, therefore, be to or by all the individual members of a firm. "The legal title to real estate can be held only by the person or corporate entity which is deemed such in law; and, therefore, a partnership cannot as such take and hold such legal title."[68] A conveyance of land to a partnership under the name of the Union Towing Company would generally be considered void, but "where the style of a partnership is inserted as grantee, and it contains the name or names of one or more of the partners, there is no reason why the title should not vest in the partners so named, and the authorities are to the effect that it would."[69] Thus, where A

[67] Percifull v. Platt, 36 Ark. 456; Hendren v. Wing, 60 Ark. 561, 31 S. W. 149, LEADING ILLUSTRATIVE CASES.

[68] Gille v. Hunt, 35 Minn. 357, 29 N. W. 2, LEADING ILLUSTRATIVI CASES.

[69] Gille v. Hunt, 35 Minn. 357, 29 N. W. 2, LEADING ILLUSTRATIVE CASES.

and B carry on business under the name of A and Co., a conveyance to A and Co. would vest title in A. A would then hold the title in part for himself and in part as trustee for B. "Where title to real estate purchased in a partnership transaction is taken in the name of one of the partners, there is a resulting trust in favor of the partnership, which may be established by parol evidence, so that the title in the one partner may be charged with the interest of the partnership."[70]

35. **Good will.**—The good will attached to the use of a certain well-established firm name may be of immense value. It often happens "that the good will is the very sap and life of the business, without which the business would yield little or no fruit. It is the whole advantage, whatever it may be, of the reputation and connection of the firm which may have been built up by years of honest work or gained by lavish expenditure of money."[71] It is no uncommon thing for a partnership to advertise a certain article so extensively as to make it a household word. Fortunes may be spent in an endeavor to make the article known to the public. No one can doubt that after such an advertising campaign there is something in a name. For this reason an old firm name is often retained by a new partnership long after the old firm has been dissolved. If the old firm name was A and Company, B, C and D sometimes carry on the old business under the old name long after A has died or retired from the partnership. While the

[70] Kringle v. Rhomberg, 120 Iowa 472, 94 N. W. 1115.
[71] Trego v. Hunt [1896], App. Cas. 7 (Eng.).

value of the good will attaching to the firm name is thus universally recognized by everybody, the subject is inherently a difficult one when it comes to defining it. An eminent English Chancellor has defined a good will as "nothing more than the probability that the old customers will resort to the old place."[72] The Civil Code of California contains this definition: "The good will of the business is the expectation of continued public patronage, but it does not include the right to use the name of any person from whom it was acquired. The good will of the business is property transferable like any other." There was a time when the tendency of English courts was not to recognize the good will of a partnership as partnership property. Modern conditions have reversed this tendency. "On the dissolution of a partnership every partner has a right, in the absence of an agreement to the contrary, to have the good will of the business sold for the common benefit of all the partners."[73]

36. **What constitutes firm property.**—Firm property "denotes everything to which all the partners are entitled as partners."[74] It goes without saying that partners on entering into a partnership may retain all or part of their individual property. A partner may retain his individual property rights even in the office furniture and trade utensils used by the partners and may merely loan their use to the firm.[75] Property may even be purchased with partnership

[72] Lord Eldon in Churton v. Douglas, Johns. 174, 188 (Eng.).
[73] Pollock, Digest of the Law of Partnership (7th ed.), p. 110.
[74] Shumaker, Partnership (2d ed.), p. 118.
[75] Ex Parte Owen, 4 De. Gex. & S. 351 (Eng.).

funds to be held by the partners as individuals. Such would be the case if the price of such purchase was charged to the partners respectively in their several accounts with the firm. Just what particular property belongs to the partnership and what to the individual partners depends upon the contract made between the parties. The capital stock of a partnership, however, whether it consists of money or other property, necessarily belongs to the partnership. The good will of a partnership is in the same class. Property bought with money belonging to the firm will be considered as firm property unless circumstances make it clear that it was intended by the partners that such property should be individual property.[76]

Whether real estate acquired by partners is partnership property is a question of the intention of the parties. "That intention may be expressed in the deed conveying the land or in the articles of partnership, but when it is not so expressed the circumstances usually relied upon to determine the question are the ownership of the funds paid for the land, the uses to which it is put and the manner in which it is entered in the accounts upon the books of the firm. Where real estate is bought with partnership funds for partnership purposes and is applied to partnership uses or entered and carried in the accounts of the firm as a partnership asset, it is deemed to be firm property."[77]

[76] Dyer v. Clark, 5 Met. 562 (Mass.).

[77] Robinson Bank v. Miller, 153 Ill. 244, 38 N. E. 1078, LEADING ILLUSTRATIVE CASES.

Where co-owners of property are partners merely in regard to the profits to be derived from their common property a different question is presented. The common property may or may not be firm assets. Thus, a theatre building owned by partners has been held to be a partnership property where the partnership business consisted in the uses to be made of it.[78] The common property may, however, be and remain the individual property of the partners. Even where additional property is purchased out of the profits of the individual property of the partners used in the partnership, it may or may not be firm property, depending upon the intent of the parties.

37. **Firm capital.**—The subject of firm capital may or may not be important to a particular partnership. In partnerships between professional men it may be of no moment whatsoever. In commercial partnerships, however, it is of the utmost importance. These partnerships require money for their successful operation. Hence it is customary for each partner on entering into a commercial partnership to contribute a certain amount of money or property to the capital of the firm. The property contributed may be in the form of a patent right, securities, good will, or anything that may be readily converted into money. The amount which each partner is to pay is usually fixed by the articles of agreement. Where this is done an obligation on each partner comes into existence to pay the part of the capital allotted to him, which obligation can be

[78] Priest v. Chouteau, 12 Mo. App. 252, affirmed in 85 Mo. 398.

enforced against him and will remain until it is paid, or until an agreement is made to discharge it. Where one or more of the partners only contribute labor or services, though these may be of value, they do not contribute to the firm capital.

38. **Nature of a partner's interest in firm property.**—A partner's interest in firm property is of a very peculiar nature. A partner does not hold an undivided share in such property which he may sell to someone else. Neither will a surviving partner take the property rights of a deceased partner by right of survivorship. A partner cannot thus convey his share during his lifetime, but will not lose it by his death. The partnership property is encumbered with the partnership obligations very much like land may be encumbered by a mortgage. The only legal interest which a partner has in the property is the right to share in what may remain of it after paying the debts and winding up the partnership. This right is all that can be attached by an individual credit of a partner.[79]

39. **Conversion of realty into personalty.**—The English law draws a distinction between real and personal property. Real estate descends directly to the heirs, while personal property goes to the personal representative of a deceased. Real estate is subject to the dower rights of the widow, while personal estate is not.

The transfer of real estate is hedged about by many restrictions, while personal property will pass from hand to hand without any formality whatso-

[79] Taylor v. Field, 4 Ves. 396 (Eng.), LEADING ILLUSTRATIVE CASES.

ever. It is far more difficult for creditors to satisfy their debts out of real estate than it is to satisfy the same out of personal property. Personal property, however, may be easily invested in real estate, and real estate, on the other hand, may be sold and thus converted into money. From these transactions injustice may result. Creditors who have a right against a certain fund may not have an equal right against the land into which this fund has been converted. In such cases a court of equity will regard that as done which ought to be done and will treat real estate as personal property or personal property as real estate, as justice may require. If partners have invested their money in real estate the courts will take into consideration that there exists an implied agreement between the partners and that partnership property should be subject to the partnership debts. Real estate acquired by a firm will, therefore, be treated as acquired with this intention and will be regarded as personal property, so far, at least, as is necessary to compel the payment of firm debts.

This rule is given somewhat greater scope in England than in the American jurisdictions. According to the doctrine followed in the English cases, partnership realty is, unless a contrary intention appears, converted into personal property for all purposes and, as such, is administered and distributed in accordance with the rules governing personal property.[80] The American courts, however, generally declare partnership real estate to be personal prop-

[80] Darby v. Darby, 3 Drew. 495 (Eng.), LEADING ILLUSTRATIVE CASES.

erty only so far as is necessary to carry on the partnership business and pay the partnership debts.[81]

40. **Dower in partnership realty.**—Dower is the provision which the law makes for a widow out of her husband's estate for the support and the nurture of her children. It usually consists of a life estate in one-third of her husband's real estate. While her husband is a partner in a firm which buys and sells real estate the question arises whether the wife is entitled to dower in such partnership real estate. This question will present no difficulty in England, because the law there regards all partnership real estate as personal property, and hence there can be no right of any wife to dower in the same. In America, however, partnership real estate is regarded as real estate and the courts all agree that the wives of the partners have dower in the same. The difficulty relates merely to the time when this interest attaches. According to decisions in New York and Massachusetts,[82] it attaches at once, as soon as it is acquired by the partners. According to other decisions, "only so much of it becomes the individual real estate of the partner as remains in specie unconverted after all the purposes of the partnership have been entirely fulfilled, and it is only to such of it that any inchoate interest of the wife attaches."[83] According to the first view, the wives of the respective partners would have to join in any deed disposing of the partnership real estate. According to the

[81] Dyer v. Clark, 5 Met. 562 (Mass.).

[82] Fairchilds v. Fairchilds, 64 N. Y. 471; Dyer v. Clarke, 5 Met. 562 (Mass.).

[83] Woodward-Holmes v. Nudd Co., 58 Minn. 236, 59 N. W. 1010.

second view, they would have to join in a deed only after the partnership had been dissolved, after its debts had been paid and after some piece of real estate remained unsold.

41. **Transfer of partnership property—By act of the firm.**—Transfers of partnership property by act of the firm may be made either to persons outside of the partnership or to some of the members of the partnership. In the latter case firm property will become the individual property of the partner or partners to whom it is assigned. In these transfers the ordinary principles of law will govern. The partners will be considered as joint owners and all will be required to join in the conveyance. The form in which such transfer so required to be made will be the same as where the parties are individuals. If land is transferred a deed will usually be required, while personal property may be transferred by mere word of mouth, or by an instrument far less formal than a deed. All these transfers, however, will always be subject to an attack if it can be shown that they are made to hinder, delay or defraud creditors of the firm.

42. **Transfer of partnership property by act of a single partner.**—A partner in a mercantile partnership has implied authority to sell the goods of the firm without the concurrence of his copartners. This power is enjoyed by an ordinary clerk in a store and certainly cannot be denied to one of the proprietors of the business. A person who purchases an article from one of the partners of a mercantile firm will, therefore, be fully protected though the other part-

ners have not joined in the sale.[84] Where, however, such a sale has been fraudulent, or where the partner has exceeded his authority, such sale may be set aside. Thus, a partner who disposes of the firm assets to pay his separate debts, exceeds his implied authority, and a purchaser, in the absence of estoppel or actual authority, will acquire no title.[85]

43. **Same subject—Successive or simultaneous transfers of each partner's interest in the partnership property.**—As has just been seen,[86] the partnership property can be sold by the act of all the partners or by the act of any one of them acting for all. It has also been explained[87] that a partner does not own any particular portion of the partnership property. His interest consists of his share of the amount remaining after the partnership affairs have been wound up and its debts have been paid. He has the right as partner to insist upon a winding up and ascertaining of what this residue is. So long as the partnership continues, however, he has no interest in any particular portion of its property. If he sells his "interest" in the partnership, his purchaser acquires title to no specific property, but only succeeds to the partner's right to have an accounting and to ascertain the amount due to his grantor after the firm has been wound up.

So long as one partner merely attempts to sell or mortgage his individual interest in the firm, no diffi-

[84] Lambert's Case, Godb. 244 (Eng.), LEADING ILLUSTRATIVE CASES. See further §§ 57-67.

[85] See § 114.

[86] § 41, 42.

[87] § 38.

culty arises. But suppose that all the partners, acting independently, sell their respective interests in the partnership property, will such successive or simultaneous independent transfers result in passing the title to the firm property? For example: A and B are partners. A sells his interest in the partnership property to X, and B sells his interest to Y. Do these two transfers put the legal title to the partnership property in X and Y? The law is well settled that if A only sells his interest to X, that X does not acquire any title to the partnership property. The property still remains subject to the partnership debts, and B, the other partner, may insist that it be applied to the payment of such debts, and A's grantee will get nothing until those debts have been discharged. This result is due to the implied agreement of the partners to devote the partnership property to the firm debts. This right which each partner has against the other to have the firm property thus used can be taken advantage of by the firm creditors so as to give them first claim on the partnership property. So long as one partner retains his interest in the firm, this right to insist upon the payment of the firm debts exists. But if each partner sells out his interest in the firm, as in the illustration above given, does this right to have the firm debts paid out of the firm property disappear? The cases are divided on this question. One line of cases holds that the successive or simultaneous independent transfers by the partners of their respective interests in the firm property do not affect the title of such property nor result in the relinquishment of

the right to have this property applied first to the payment of the firm debts. In jurisdictions where this is the law, the firm creditors are not affected by such sales, because they may follow the firm property and subject it to the payment of their debts. The other line of cases holds that such a transfer not only passes the legal title to the firm property, but also extinguishes the rights of the respective partners to have the firm property applied to the payment of the firm debts. In such jurisdictions, the firm creditors lose their priority against what was firm property.

44. **Effect of death of partner on firm property.**—While all the partners are alive they will have both the legal title and the beneficial enjoyment of all the firm property. When, however, one of the partners dies this condition is changed. The surviving partners will hold all the personal property of the firm, partly for their own benefit and partly for the benefit of the heirs or representatives of the deceased partner. So far as the share of such heir or representative is concerned, the partner will have the bare legal title, while the heir or representative of the deceased partner is entitled to the enjoyments flowing therefrom. The same doctrine is held in England in regard to partnership real estate. In America, however, such real estate will vest directly in the heirs of the deceased partner, according to their interests therein, without the intervention of a trustee. A surviving partner or the heirs of the deceased partner holding the legal title of course will hold it for the purpose of paying the firm debts

and settling the firm affairs before the beneficial owner of the title will be entitled to anything. As soon as the debts of the firm are satisfied and the affairs of the firm settled the residue will have to be turned over to such heirs or representatives of the deceased partner.[88]

45. **Surviving partner's relation to partnership property.**—Where one of the partners dies the duty to take care of the firm property and close out partnership affairs devolves upon the surviving partner. He is bound to pay the firm debts and distribute the balance of the firm assets among the partners and their representatives according to their respective interests. In doing this he must act with the same honesty, integrity and fidelity which he is bound to exercise while the partnership still existed. "On the death of a partner the law confers on his representatives certain rights as against the surviving partner and imposes on the latter correspondent obligations. The surviving partner may be called, so far as these obligations extend, a trustee for the deceased partner."[89] If he fails to rise to the measure of his responsibilities the representative of the deceased partner may "invoke the interference of a court of equity and compel such a disposition of the partnership effects as will be just and proper."[90]

46. **Partnership agreement controlling property after death of partner.**—It is often provided in partnership agreements that on the death of one partner

[88] Andrews' Heirs v. Brown's Adm's, 21 Ala. 437, LEADING ILLUSTRATIVE CASES.

[89] Knox v. Gye, L. R. 5 H. L. 656 (Eng.).

[90] Emerson v. Senter, 118 U. S. 3.

his interest in the partnership business is to be transferred to a person of his choice. This person may be one of the other partners or some other person as yet unconnected with the partnership. If such an agreement is made it will be binding on the surviving partners, as they thereby waive their right to object to the admission of a new member into the firm. Of course, such an agreement is not binding upon the person nominated to take the place of a deceased partner. If such third person chooses not to go into the partnership the nomination will fail of its purpose. If, however, the nominee chooses to go into the partnership, he must comply with the terms upon which he is entitled to do so.[91]

[91] Holland v. King, 6 C. B. 727 (Eng.).

CHAPTER IV.

NATURE, EXTENT AND DURATION OF PARTNERSHIP LIABILITY.

47. **Nature of partnership liability in contract.**—We have seen that a partnership is not a separate legal being like a corporation. It can, therefore, as such, enter into no contract. If a contract is made it is the contract of its members. A contract made by the firm of Smith and Jones is, in legal conception, the contract of Mr. Smith and Mr. Jones. A contract may be joint, several, or joint and several. It is joint where each of the promissors promise for all. It is several where each promises for himself alone. It is joint and several where each promises for himself and for all the others. If A and B make a joint contract there is but one cause of action against them, because there is but one promise. If they make a several contract there are two causes of action against them, one against A and one against B. If they make a joint and several contract three causes of action come into existence,—one against A, one against B and one against A and B. The obligation of partners with respect to partnership transactions is joint. If a creditor of a partnership wants to enforce such a contract against the partners he must join all the partners as defendants. If he leaves out one of them, the other partners may have the action dismissed. If the creditor releases A he will also release B, since B has contracted a joint

liability with A and the creditor is in no position to change this contract to the disadvantage of B. If a judgment is recovered against less than all the joint debtors the debtor who has not been joined will thereby be released from the obligation, as there is but one cause of action, which has been merged in the judgment.

This rule in regard to joint liability has been changed by statute in many of our states. These statutes in effect have made the partnership liability joint and several by allowing less than all of the partners to be sued in certain cases, though they thereby discharge those partners who are not joined as defendants.

But whether the obligations incurred by partners before judgment are joint or joint and several, the creditor, after recovering judgment, may enforce the same against either or all of the partners. Each partner is personally liable for all the debts of the firm. "The law, ignoring the firm as anything distinct from the members composing it, treats the debts and engagements of the firm as the debts and engagements of the partners, and holds each partner liable for them accordingly." [92]

48. **Same subject—Estate of deceased partner.**—One of the incidents of joint contracts is that if one or more of the joint contractors die, the survivors take the benefit or the burden connected with their joint contract, and are the only ones to sue or be sued upon it. This doctrine will apply to the joint con-

[92] Lindley, Partnership (5th ed.), 200; Benchley v. Chapin, 10 Cush. 173 (Mass.), LEADING ILLUSTRATIVE CASES.

tracts of a partnership, but will in many cases lead to great hardships by subjecting the survivor to obligations which he has only assumed jointly with his deceased associates and which he never expected to pay severally. Since the estate of a deceased partner is entitled to its share of the firm property, it is only just that it should bear its share of the burdens of the partnership. Hence a court of equity will keep alive a liability assumed by a deceased partner and will enforce this liability against his estate. "The court, in order, before distributing assets, to administer all the equities existing with regard to them, would go behind the legal doctrine that a partnership debt survives as a claim against the surviving partners only and would give the creditors the benefit of the equity which the surviving partners might have insisted on."[93] For this reason it has sometimes been stated that joint contracts are joint and several in equity.

While this doctrine of equity, that the estate of a deceased partner can be made liable for the partnership obligations, is well settled, there is conflict in the decisions as to the time when this right to subject the estate of a deceased partner to this liability arises. In England and in some of the United States it has been established that the estate of a deceased partner is liable immediately after his death.[94] Other courts hold that the surviving partners succeed primarily to all the rights and interests of the

[93] Kendall v. Hamilton, L. R. 4 App. Cas. 504, p. 516 (Eng.).

[94] Wilkinson v. Henderson, 1 M. & K. 582 (Eng.); Doggett v. Dill, 108 Ill. 560.

partnership, and have the entire control over the partnership property and the sole right to collect the partnership dues; therefore, the assets of the firm are to be regarded as the primary funds for the payment of the firm debts, and the surviving partners having possession of these assets should first be called upon before the estate of the deceased partner can be held.[95]

49. **Extent of partnership liability in contract.**—A contract "when made with partners is originally a joint contract, but may be several as to its effects. Though all are sued jointly and a joint execution taken out, yet it may be executed against only one."[96] Though suit to enforce such a contract should be brought against all the partners, a judgment rendered against them may be satisfied out of the separate estate of any of them. Each partner is personally liable for the whole debt contracted by the partnership. As long as one partner has property subject to execution a judgment creditor of the partnership may obtain satisfaction of his debt, though the partnership itself and the other partners are bankrupt. No agreement made between the partners can change this liability of each separate partner as against creditors. The only effective way by which a partner can limit his liability is by becoming a special partner by complying with the statutes providing for the organization of limited partnerships.[97]

[95] Voorhis v. Child's Ex'r, 17 N. Y. 354.
[96] Abbott v. Smith, 2 W. Blackstone 947, p. 949 (Eng.).
[97] See §§ 128-131.

50. **Commencement of partnership liability in contract.**—Persons may contract a joint liability without being partners. They may both sign such a contract, or authorize one of their number to make the contract for all of them. In the latter case a joint contract has come into existence, if at all, because it has been authorized by all the parties affected by it. Such a contract rests upon the ordinary principles of agency and is entirely independent of any partnership obligation. A partnership involves the right of one partner to bind his copartners by contracts within the scope of the particular business carried on by the partnership. Until a partnership is formed no such power can exist. Hence, there can be no partnership liability in contract before the partnership has been formed. When, however, a partnership has in fact been formed, whether the parties to it realize that they are partners or not, a contract made by one will jointly bind them all.

51. **Same subject—Incoming partner.**—It is customary to speak of an incoming and a retiring partner. What really takes place, however, in legal conception, when a new partner comes into the firm or an old partner retires, is a dissolution of the old partnership and the formation of a new one. A new member does not join an old firm, but rather forms a new partnership with the members of the old firm. He does not by merely associating with some or all of the members of the old firm become liable for their debts. He was not a partner when the debts were created, and hence he is not responsible for them, unless he has done something more than be-

come a partner of some or all of the old members of the firm.

The method by which an incoming partner becomes liable for the debts of the old partnership may take various forms. The old partners and their creditors may have a joint meeting in which they agree that the liability of the retiring partner is to be assumed by the incoming partner and that the retiring partner is to be released from such liability. If this is done the old contract is rescinded and a new contract has come into existence, which, of course, is binding on the members to it. This transaction is known as novation. "There must be a novation before a new firm is liable and the new contract must receive the consent of all the parties and must have the effect to extinguish the old contract and create a new liability of debtor and creditor, * * * and such new contract must be based on some consideration."[96]

Generally, however, the creditors of a partnership are not consulted when a new partner is added. All that occurs may be a promise of the new partner to assume the debts of the old partnership. The question then is whether or not the creditor can enforce this agreement made between the old and the new partner, to which he is not a party. This question has been differently answered by the various courts. Some courts hold that such contracts are enforcible at the suit of the creditor, while other cases adhere to the strict doctrine that a contract can be enforced only as between the parties to it. Those courts that

[96] Parmalee v. Wiggenhorn, 6 Neb. 322.

permit a creditor to take advantage of the promise of an incoming partner to pay the existing debts of a firm which he joins do so on the ground that this promise is made for the benefit of the creditor, and, therefore, as beneficiary, he may enforce the performance of such promise, although he is not a party to the contract.

52. **Liability of retiring partner.**—The mere retirement of a partner from a partnership does not affect his liability toward the firm creditors. They have contracted with him and may hold him liable for all the debts of the partnership created while he was a partner. Debtors cannot by any agreement which they may make with themselves, or with any other persons, affect the rights of their creditors. In order to release a retiring partner from his firm obligations it is necessary that this release be obtained from the creditors themselves. If the creditors agree for a valuable consideration to release a retiring partner, such contract, of course, will be enforcible against them. Such a release is often effected when one partner retires and a new partner is taken in. The creditors may expressly or impliedly agree to substitute the incoming partner for the retiring partner, and, if this is done, the retiring partner will be released from his obligation.

Some courts, however, have held that on the retirement of a partner from a firm he ceases to be principally liable, and in fact becomes merely a surety for his former copartners. A creditor who has notice of his retirement is then bound to hold the remaining partners primarily and to resort to

him only in case he is not able to realize his debt from the remaining partners.[99]

53. **Termination of contract liability as to past transactions.**—Joint liabilities contracted by the members of a partnership may, of course, be terminated by payment of these liabilities out of the partnership fund. This is the usual and most natural means of terminating these liabilities. The questions of difficulty that arise will relate to the application of certain payments. Suppose the firm of A and B dissolves by the retirement of B, and A thereupon takes in a new partner, C. Suppose, further, that the old firm of A and B had a running account with a creditor and this running account is continued by the new firm of A and C without a break. The new firm contracts new liabilities and makes certain payments from time to time without indicating to which particular item these payments are to be applied. Under these circumstances a legal presumption will arise that the payments are to be applied to the oldest items of the account and A and B will be discharged from liabilities as fast as payments are made in accordance with this rule.

A creditor may also see fit to release one or more of the partners from his joint obligation. Since the partners contracted to be jointly liable, a release of one of them will terminate the liability of all, since the creditor cannot by getting together with one of his debtors change the liability of any of his other debtors to their detriment. Where, however, a debtor who is thus released agrees to such a qualifi-

[99] Gilmore, Partnership, p. 256.

cation of the release as will leave him liable to any rights of his co-debtors, this reasoning will not apply.[1]

A joint liability may also be discharged if the creditor obtains a judgment against one of his debtors. Such judgment is said to merge the cause of action. "When a contract is joint and not joint and several, the entire cause of action is merged in the judgment. The joint liability of the parties not sued with those against whom the judgment is rendered being extinguished, their entire liability is gone. They cannot be sued separately, for they have incurred no several obligation. They cannot be sued jointly with the others, because judgment has been already recovered against the latter, who would otherwise be subject to two suits for the same cause."[2]

The joint obligation of partners may also be extinguished by what is known as novation; that is to say, on the retirement of one or more of the partners and the admission of a new partner or partners, the old and new members of the partnership may agree with the creditors that the members of the old partnership are to be released and that the members of the new partnership are to take over the liability of the former partners.[3]

54. **Termination of contract liability as to future transactions.**—As long as a partnership relation continues the partners are agents of each other and are

[1] North v. Wakefield, 13 Q. B. 536 (Eng.).
[2] Mason v. Eldred, 6 Wall. 231 (U. S.).
[3] See § 51.

bound by contracts made by either of them within the scope of their business. This liability continues while the partnership exists. It may even continue after the partnership is dissolved. In this regard a distinction is made between the dissolution of the partnership by operation of law, and the dissolution by act of the parties. If a partnership is dissolved by operation of law, such as the death of the partner, or by any event through which the business carried on by the partners becomes illegal, the agency of each partner is terminated and he will henceforth have no power to bind his copartners; even if no notice of the death of a partner is given to anyone this result will obtain. Where, however, a partnership is dissolved by mutual agreement of the parties it will be necessary to give notice of this fact to the world before the liability of the partners will terminate.

55. **Notice of dissolution—Former dealers.**—The notice to be given of a dissolution of a firm will vary as the persons who are the recipients of it vary. It is obviously impossible to bring home actual notice of the dissolution of a partnership to those who have not had any dealings with the partnership. In regard to such people it is sufficient that reasonable means be used to make them aware of the change in the firm. What are reasonable means must depend upon circumstances. "Notice fairly given in a newspaper generally circulated abroad and particularly among the business people of the town or city where the partnership carried on its business, would be sufficient as to all persons who had not had previous

dealings with the partnership."[4] This will also be the easiest way to impart such knowledge to the world. However, "it is not an absolute inflexible rule that there must be a publication in a newspaper to protect the retiring partner. That is one of the circumstances contributing to or forming the general notice required. This is an important one, but it is not the only or an indispensable one."[5] Any means which are fair means to publish as widely as possible the fact of dissolution, or means so public and notorious as to put the public on its guard, withdrawing exterior indications of partnership, may be sufficient to impart the general knowledge to the general public.

Where, however, a person has had actual dealings with the partnership a more personal and actual notice brought home to him will be required to relieve the partners from future liability. Such notice is within the range of possibility, since the names of people who have dealt with the partnership will be found on the books. But not everyone who has had dealings with a partnership will for that reason be considered as a former dealer. "The essential requisite in order to constitute one a former customer, entitled to actual notice, is dealing with the partnership on credit."[6] Therefore, it is held that those who have dealt with the firm for cash are not entitled to greater notice than the public generally.[7]

[4] Ellison v. Sexton, 105 N. C. 356, 361, 11 S. E. 180, 181.

[5] Lovejoy v. Spafford, 93 U. S. 430, 440.

[6] Gilmore, Partnership, p. 268; Austin v. Holland, 69 N. Y. 571, LEADING ILLUSTRATIVE CASES.

[7] Askew v. Silman, 95 Ga. 678, 22 S. E. 573.

Where, however, credit has been extended to the firm, the person so extending credit is entitled to actual notice.

Just what amounts to actual notice is often a question of difficulty. "It is often difficult to determine what amounts to a due and sufficient notice of the retirement of a partner, but the evidence to prove it should be such as would reasonably warrant the jury in finding the fact of notice."[8]

The rule in regard to notice does not apply where a dormant partner retires from a firm. The existence of the dormant partner was not known to the creditors. No reliance has been placed upon his credit, and hence it is held that he may retire without giving notice. Of course, if he was known to some persons to be a partner he had ceased to be a dormant partner as to such person and would be required to give notice on retiring from the partnership.

56. **Nature and extent of liability in tort.**— Where partners make a contract in the partnership name such contract will be a joint contract and can be enforced only by joining all the partners as defendants in an action. Where, however, the partnership commits a wrong or a tort, a joint and several liability will arise. The reason for this distinction is that the contract liability rests upon the intention of the parties, while a tort liability is imposed by law with special regard to the rights of the injured person. If, therefore, a tort is committed against a person by a partnership composed of A

[8] Ellison v. Sexton, 105 N. C. 356, 361, 11 S. E. 180, 181.

and B, such person has three rights of action, one against A, one against B and one against A and B.

What particular acts of a partner will subject the partnership to a tort liability is a question which is not easy to answer. The main question will always be: was the act complained of committed in carrying on the firm business in the usual manner? Thus, a libel published in a partnership paper as news will make all the partners liable.[9] Where, however, a table is returned to a furniture partnership and one of the partners places a placard on it, saying: "Taken back from Dr. M—, who would not pay for it. To be sold at a bargain. Moral: Beware of dead beats," the libel thus uttered is not sufficiently connected with the firm business to make any of the other partners liable.[10]

[9] Lothrop v. Adams, 133 Mass. 471.

[10] Woodling v. Knickerbocker, 31 Minn. 268, 17 N. W. 387. As to power of partner to subject firm to tort liability, see § 66.

CHAPTER V.

POWERS OF PARTNERS.

57. **Powers as between themselves.**—As between themselves partners have such powers, and no more, as they may have agreed upon. It is usual for persons upon entering into the partnership relation to stipulate what powers each partner is to possess. If such a contract is made the parties to it will be bound thereby. If any of them should exceed his powers he will be liable to his copartners for the damages resulting therefrom. If no express agreement is made in regard to the power which each partner is to have all will have equal rights to the management of the firm business, and will, by implication, possess the ordinary powers incidental thereto.[11]

58. **Powers of partner to bind firm.**—A partner may bind his copartners by acts within the actual or apparent scope of his authority. By the actual scope of authority is meant the extent of the authority conferred upon the partners by the terms of the partnership agreement. If the agreement is silent on these matters, such acts as are necessary to carry on the partnership business in the usual way will be regarded as within the actual scope of the partnership authority. It goes without saying that one partner is bound by the acts of his copartners within

[11] Lloyd v. Loaring, 6 Ves. 773 (Eng.). See §§ 71, 77.

the actual scope of their authority. Thus, A, a partner in a firm of shopkeepers, has actual authority from B, his partner, to sell goods over the counter. This authority may be conferred upon him by the partnership articles. If this has not been done, it will be implied from the nature of the business.[12] If, however, the partnership agreement between A and B should provide that A was to have no power to sell, there would be no actual authority for B to sell over the counter. If he sells goods, nevertheless, and breaks his agreement with B, he becomes liable to him. Now, C walks into the store to buy an article. He knows nothing of the partnership agreement. He would be regarded as an impertinent person if he was to inquire about it. He sees A in the store and negotiates for a sale. C has the right to rely upon the apparent authority of A to sell and may close a bargain with A which will bind B. If C had known of the limitations of A's authority, a different question would arise. He would have acted with notice and would not be protected.

59. **Test of implied powers.**—In testing the implied power of a partner a number of considerations must be borne in mind. The scope and nature of the particular business in which the partners are engaged must be inquired into, as well as what is reasonably and usually necessary to carry on that business in the ordinary way. If the member of a firm of attorneys should proceed to collect a note without charge, such act would not be binding upon his copartners, since gratuitous undertakings are not

[12] Lambert's Case, Godb. 244 (Eng.), LEADING ILLUSTRATIVE CASES.

within the scope of the firm business.[13] If persons form a partnership for the purpose of farming, the very nature of their business will forbid acts of buying and selling which would be perfectly proper in a trading partnership.[14] "Where a partnership is limited to a particular trade or business, one partner cannot bind his copartner by any contract not relating to such trade or business and third persons will be presumed to have knowledge of the limited nature of the partnership from circumstances connected with the business of the firm."[15] But it is not sufficient that the particular act be within the scope and nature of the partnership. It must also be reasonably necessary to carry on the business in the ordinary way.[16] It is not enough that the act in question is convenient for the purpose nor will there be implied power to a partner if the act is in any sense unusual or the necessity an extraordinary one.

60. **Trading and non-trading partnerships.**—The question, what acts are within the apparent authority of a partnership, will depend upon the general nature of the firm business. A member of a firm of shopkeepers obviously will have powers different from those of a member of a firm of physicians. A special distinction is, therefore, made between professional partnerships and commercial partnerships. Acts that are within the apparent authority of a commercial partnership, are presumptively unauth-

[13] Davis v. Dodson, 95 Ga. 718, 22 S. E. 645.

[14] Woodruff v. Scaife, 83 Ala. 152, 3 So. 311.

[15] Livingston v. Roosevelt, 4 Johns. 251 (N. Y.).

[16] Pooley, Barnum & Co. v. Whitmore, 10 Heisk. 629, p. 633 (Tenn.), LEADING ILLUSTRATIVE CASES.

orized when attempted by a partnership of attorneys or physicians. "The question whether a given act can or cannot be necessary to the transaction of the business in the way it is usually carried on must evidently be determined by the nature of the business and by the number of persons engaged in it. Evidence on both these points is necessarily admissible and, as readily may be conceived, an act which is necessary for the transaction of one kind of business may be wholly unnecessary for the carrying on of another in the ordinary way."[17]

61. **Ratification and estoppel.**—Ratification is the confirmation of a voidable act or contract. Where a partner does an act which is beyond his express or implied powers such act may be ratified by his copartners. If this is done it will become binding upon them. Thus, an unauthorized contract of purchase by one partner may be ratified by the failure of the other partners to repudiate the contract before the goods are delivered.[18]

An estoppel has been defined as that which "shuts a man's mouth from speaking the truth." The other partners may occupy such a position that a court will not allow them to repudiate an act of their copartner, though in fact such act was not authorized by them. Thus, partners who negligently permit their copartner to circulate notes purporting to be genuine firm obligations, will be estopped from setting up that such notes were in fact fraudulent and

[17] Pooley, Barnum & Co. v. Whitmore, 10 Heisk. 629, p. 635 (Tenn.), LEADING ILLUSTRATIVE CASES.

[18] Hatchett & Large v. Sunset Brick & Tile Co., 99 S. W. 174 (Tex.).

made for the accommodation of persons outside of the partnership business.[19]

62. **Power to buy and sell—Borrow money.**—A member of a mercantile firm has implied power to sell goods.[20] The business in which he is engaged implies such authority. Without such power no trading partnership is possible. But in order to sell goods a trade partnership must also buy. It follows that both buying and selling are within the implied powers of every trading partnership. This power, however, extends still further. Most business is conducted on credit. The great mass of the sales that are made are not made on a cash basis. A trading partnership may therefore buy on credit and may even borrow money outright. Thus, where a partnership is made in London and one of the partners goes to Manchester on business and borrows money at Manchester in the name of the partnership to enable him to return to London, the partnership is liable for the money thus borrowed.[21]

63. **Power to execute commercial paper.**—Without any express stipulation in the partnership agreement "every member of an ordinary partnership is its general agent for the transaction of its business in the ordinary way and the firm is held responsible for whatever is done by any of its partners when acting for the firm within the limits of the authority conferred by the nature of the business it carries on * * * but no person is entitled to assume that any

[19] Bank of Monongahela Valley v. Weston, 172 N. Y. 259, 64 N. E. 946.

[20] Tapley v. Butterfield, 1 Met. 515 (Mass.), LEADING ILLUSTRATIVE CASES. See also § 58.

[21] Rothwell v. Humphreys, 1 Esp. 406 (Eng.).

partner has more extensive authority than that above described."[22] The nature of the business and the practice of people following it is the touchstone with which to test this implied power. Thus, the making of notes and the acceptance of bills of exchange is part and parcel of a mercantile venture. Notes and bills originated in such ventures and are necessary for their successful operation. Merchants must have goods to sell and in order to obtain them on credit they must execute notes and accept bills. It follows that a partner in a mercantile firm has implied power to execute notes and accept bills of exchange for the firm. "By the custom of England where there are two joint traders and one accepts a bill drawn on both, for him and partner, it binds both, if it concerns the trade."[23] A different question would arise in a partnership between professional men, such as lawyers or doctors. It is not customary nor necessary for lawyers or doctors to execute notes or accept bills of exchange. Their business does not require it. They do not buy on credit and sell, but they simply render services. It follows that a member of a professional partnership has no implied power to execute commercial paper for the partnership.[24]

But the line between professional and trading partnerships is not always so plain. Suppose A and B engage in a partnership for the purpose of boring wells and buying pumps and wind-mills and putting them together and placing them into wells bored by

[22] Pooley, Barnum & Co. v. Whitmore, 10 Heisk. 629, p. 633 (Tenn.).
[23] Pinkney v. Hall, 1 Salk. 126 (Eng.).
[24] Hedley v. Bainbridge, 3 Q. B. 316 (Eng.).

the firm. A executes a note to pay the firm debts. The question, whether he had authority to do so or not, is a question of fact depending upon all the circumstances of the case and is a proper question to be submitted to a jury.[25]

64. **Power to execute deeds.**—The old English law did not regard land as an article of trade. It regarded land rather as an estate granted by the king to his loyal subjects. The sale of this land was encumbered by so many restrictions as to discourage any attempt to deal in land. No partnerships for the dealing in real estate were thus possible in the early days of the English law. It followed that making a deed was out of the usual course of a partnership business, and hence it was held that no partner had implied authority to execute a deed for his copartner. Since a deed was an instrument under seal the rule was extended to all sealed instruments, although there were documents under seal which pertained to trade and commerce, such as a charter party.[26] This broad rule was found to be inconvenient and exceptions were engrafted upon it. Thus it was held that one partner may execute a sealed instrument releasing a firm debt.[27] Where all the partners were personally present while one of them executed a sealed instrument the same has also been upheld.

Even a private verbal authority, or subsequent ratification of the act of the partner in executing a sealed instrument has been held sufficient to validate

[25] Vetsch v. Neiss, 66 Minn. 459, 69 N. W. 315.
[26] Straffins, Administrator, v. Newell, Carlt. 163 (Ga.).
[27] Piersons v. Hooker, 3 Johns. 68 (N. Y.).

it. Where the seal was unnecessary to the validity of the particular instrument it has simply been disregarded by the courts and the contract upheld as a merely written one. Many of the American states have gone still further. Some of them have abolished seals altogether, while others have practically done so. To avoid difficulty and litigation, however, it will be found advisable if partners intend to execute a sealed instrument, that every one of them should join in the same. In this way no difficulty can possibly arise in connection with the execution of the instrument.

65. **Power to assign for the benefit of creditors.**—An assignment for the benefit of creditors takes place when a debtor transfers his property to another in trust to pay his debts. Some courts have argued that since a partner in a trading firm has power to sell the property of the partnership he also has power to assign this property to a trustee for sale and distribution among the firm creditors. Other courts, however, argue that such an assignment in fact destroys the partnership, and hence is beyond the implied power of any partner. This latter view has been generally adopted, and most courts hold that such an assignment to be valid must be consented to by all the partners who are in the jurisdiction and who are accessible. This consent need not be directed to the act of the assignment. If a partner writes to his copartner to take charge of the entire business and close it up speedily, he thereby gives authority "to make such disposition of the partnership property as should be deemed most expedient to close up the part-

nership enterprise," including an assignment for creditors.[28]

66. **Power to subject firm to tort liability.**—It is familiar law that a master is responsible for the wrongs committed by his servant within the scope of his employment. If an owner of an automobile sends out his chauffeur on an errand and the chauffeur while on such errand negligently injures a person the owner is liable for the damage thus occasioned. If the chauffeur had taken the master's car and gone out on a frolic of his own, the master would not be liable because in that case the chauffeur would not have acted within the scope of his employment. Each partner is the agent of his copartners just as the chauffeur is the servant of the owner of the car. It follows that all the partners are liable for the wrongful act committed by one of them, provided such act is within the scope of the partnership business. Thus where a partner in a manufacturing firm slanderously states that a partnership has brought suit against a competing manufacturing company for an infringement on a patent on an article which both are selling, the partners are liable for such wrong because the statement was made for the purpose of aiding the business of the partnership by injuring the competing business.[29]

On the other hand, where a partner in a firm of attorneys receives money for the purpose of investing it, but uses it for his own purpose, his partners are not liable for the wrong because receiving money

[28] Welles v. March, 30 N. Y. 344.

[29] Haney Mfg. Co. v. Perkins, 78 Mich. 1, 43 N. W. 1073.

jointly for the purpose of letting it out is without the scope of a lawyer's business.[30]

This rule of the liability of a partner for his copartner's acts is applicable even to an offense requiring guilty knowledge. Suppose A is a guardian of the poor. The statute prohibits such a guardian under a penalty from giving or furnishing for his own profit any goods or materials to the poor. His partner B, however, sells a bedstead to a pauper and draws pay for the same from the public treasury. A is liable for a penalty even though he had no actual knowledge of the sale because he is a partner of B and will take part in the profits of the sale of the bedstead.[31]

This rule, however, does not extend so far as to make a partner liable to the state for a criminal act committed by his copartner. To make one liable for a criminal act of another he must have directly authorized the same. No such authority to commit a crime will be deduced by implication from the partnership agreement even though the particular act was committed for the purpose of furthering the partnership business.

67. **Powers of partners after dissolution.**—When partners dissolve the partnership relation the mutual agency which previously existed between them ceases. Much of the power which the partners previously enjoyed will thereafter be gone. However, there may be large accounts outstanding which must be collected. It may also be necessary for the benefit

[30] Harman v. Johnson, 2 El. & Bl. 61 (Eng.).
[31] Davies v. Harvey, L. R. 9 Q. B. 433 (Eng.).

of all concerned to carry on the business until some other arrangements can be made. It is, therefore, held that on the dissolution of a firm there still exists sufficient power in the remaining partners to close up the firm business and pay its debts. The scope of this power will not extend further than to such acts as are reasonably necessary to accomplish this end. While the partners after dissolution will have no power to incur new obligations, they may perform the existing contracts of the firm and pay and settle the firm debts. Each partner has power to dispose of the firm assets and to collect the firm debts. The power to make admissions binding on the firm is generally held to be limited to such admissions as relate fairly to the settlement of the partnership affairs. Where the partnership has dissolved by the death of one or more of the partners, the remaining partner or partners will necessarily have to act for the partnership, and will be held to a strict account by a court of equity. For this reason it has sometimes been stated that they become trustees of the firm property. In a general way, they have all the powers possessed by partners who have voluntarily dissolved their relation.

Each partner has an equal right with his copartners to take part in winding up the affairs of the partnership. Sometimes, however, they agree that one of their number shall take entire charge of the winding up. The partner to whom this duty is delegated is called the liquidating partner.

CHAPTER VI.

DUTIES AND LIABILITIES OF PARTNERS AS BETWEEN THEMSELVES.

68. **Duty of partners to conform to the partnership agreement.**—"One of the most obvious duties and obligations of all the partners is strictly to conform themselves to all the stipulations contained in the partnership articles and also to keep within the bounds and limitations and rights, powers, authorities and acts belonging to and appropriate to the due discharge of the partnership trade or business."[32] It is usual, of course, for prospective partners on entering into a partnership agreement to execute what is called articles of agreement. "The duties and obligations arising from the relations between the parties are regulated by the express contract between them so far as the express contract extends and continues in force."[33] It is of course not possible in these articles to make provision for every contingency that may arise. They would become so bulky as to defeat the object for which they are formed. As long as the partners are harmonious they will be able to dispose of any new questions without difficulty. If the old agreement does not fit the case any more it can at any time be changed or superseded. "The parties being competent to act as they please, they may put an end to or vary it

[32] Story, Partnership (7th ed.), § 173; Murphy v. Crafts, 13 La. Ann. 519, LEADING ILLUSTRATIVE CASES.

[33] Smith v. Jeyes, 4 Beav. 503, p. 505 (Eng.).

at any moment. A partnership agreement is therefore open to variation from day to day and the terms of such variation may not only be evidenced by writing but also by the conduct of the parties in relation to the agreement and to their mode of conducting their business."[34] This contract with all its subsequent changes will govern the actions of the partners.

Where, however, the contract does not cover any particular act the same will be regulated by the general law applicable to partnerships. If the contract is silent on the powers which the various partners possess each partner will be treated as the agent of every other partner and any act which he has done within the scope of the business of the partnership will be treated as the act of all the partners.

69. **Duty to observe good faith.**—"The utmost good faith is due from every member of the partnership toward every other member, and if any dispute arises between persons touching any transaction by which one seeks to benefit himself at the expense of the firm, he will be required to show not only that he has the law on his side, but that his conduct will bear to be tried by the highest standard of honor."[35] Partnership being a relation of confidence, absolute good faith is the very basis of it. It is "well settled that one partner cannot directly or indirectly use partnership assets for his own benefit; that he cannot in conducting the business of a partnership, take

[34] England v. Curling, 8 Beav. 129, p. 133 (Eng.).

[35] Roby v. Colehour, 135 Ill. 300, 338, 25 N. E. 777; Mitchell v. Read, 61 N. Y. 123, LEADING ILLUSTRATIVE CASES.

any profit clandestinely for himself; that he cannot carry on the business of the partnership for his private advantage.'"[36] Whatever benefit or advantage a partner derives he must derive because the partners as a whole have been benefited.

Suppose A and B are in partnership for the purchase of precious stones. A is the buyer for the firm. Instead of paying cash for the stones he exchanges them for goods in his store. He charges the partnership with the price which he has set on these goods and keeps the profits realized from the goods for himself. This is a breach of the good faith which he owes to A and the court will compel him to account to A for one-half of the profits B realized.

The requirement that partners must exercise the most scrupulous good faith toward each other is not confined to the time during which they are actual partners. It extends to those who are closing up a partnership and even to those who are negotiating for a partnership not yet formed. Suppose A has bought a stallion for $1,200. He enters into a partnership with B. B believes that the stallion is still the property of the former owner. He authorizes A to buy the stallion for $1,800, and A makes believe that he has done so and charges the partnership accounts with this amount, keeping $600 for himself. A cannot do this and will be forced to account to B.[37]

70. **Duty of partner to use care and skill.**—It is the duty of each partner in the conduct of the partnership business, to exercise reasonable care and

[36] Latta v. Kilbourn, 150 U. S. 524.

[37] Bloom v. Lofgren, 64 Minn. 1, 65 N. W. 960.

skill. For any negligence or for any failure to exercise reasonable care and skill he will be liable to his copartners if damage is caused thereby. Beyond this the liability of a partner for care and skill does not extend. He is not liable if damage is caused by his lack of discretion, or by poor judgment which does not amount to negligence or bad faith. Thus, if one member of a firm of bankers makes an investment which later turns out to be bad, he will not be personally liable to his copartners because he has not taken the utmost precaution possible in making that investment.[38]

71. **Power of the majority.**—A partnership agreement may provide who is to control in case of dissent among its members. Generally, however, partners when drawing up the partnership agreement do not expect trouble and dissension. Most partnership agreements in consequence do not make any provision for this case. It becomes necessary, therefore, for the law to supply this omission. Where the partners have disagreed the law will allow the majority to act, rather than allow the minority to put a stop to the business. There must, however, be a majority. Where the partners are equally divided, one against one in a partnership of two, or two against two in a partnership of four, and all have an equal voice in the management, no action in the matter on which a disagreement exists is possible, for there is no majority. "In such case the duty of each partner would require him not to enter into any contract from which the other in good faith dissents; and if he did it would

[38] Exchange Bank of Leon v. Gardner, 104 Iowa 176, 73 N. W. 591.

be a violation of the obligations which were imposed by the nature of the partnership. It would not in fact be the contract of the firm; and the party with whom it was made, having notice, could not enforce it as such."[39] It is upon this principle that one partner cannot engage a new or discharge an old servant against the will of his copartner.[40]

But even where there is a clear majority, the power of such majority is not unlimited. The majority members must act in good faith for the benefit of the firm as a whole. They cannot trample under foot the rights of the minority in order to gain an advantage for themselves. They must give the minority a chance to be heard. "All partners are bound to be true and faithful to each other. They are to act upon the joint opinion of all, and the discretion and judgment of any one cannot be excluded. What weight is to be given to it is another question."[41] There is a further limitation on the power of the majority members. They can do only such things as are contemplated by the partnership agreement. They cannot tear away the partnership from its old moorings. They cannot change a partnership for the practice of law into a partnership for the sale of real estate. Any one of the dissenting members could stop any such action even though he was only one out of twenty-five.

This rule as to power of the majority, however, applies only as between the partners. As against

[39] Johnston & Co. v. Dutton's Adm'r, 27 Ala. 245.

[40] Donaldson v. Williams, 1 Cromp. & M. 345 (Eng.).

[41] Const. v. Harris, Turner & Russell's Rep. 496, 525 (Eng.).

third persons, each partner is the agent of every other partner, and the partnership will be bound by a contract of any member of it with a third person, provided such contract is within the apparent scope of the partnership business and the third person had no knowledge of any breach of the agreement as between the partners.

72. **Right of partner to participate in the management of the business.**—Partners may regulate by their partnership agreement just what share each is to have in the management of the business. They may confide one duty to one or more partners exclusively and may even exclude a partner entirely from the management of the business. In the absence of any such stipulation, however, all the partners have an equal share in the management of the business. In partnerships the good faith of every partner is pledged mutually to each other that the business shall be conducted with their actual personal interposition so that each may see that the other is carrying it on for their mutual advantage. This rule applies even though the entire capital invested is contributed by one of the partners. "Although one of them may have an interest only in the profits and not in the capital, yet his rights are involved in the proper conduct of the affairs of the firm so that profits may be made."[42]

73. **Right to inspect firm accounts and be generally informed as to the firm business.**—The partners in a firm are joint principals and are all vitally inter-

[42] Katz v. Brewington, 71 Md. 79, 20 Atl. 139, LEADING ILLUSTRATIVE CASES.

ested in the success or failure of the firm. It follows that the individual partners, whether they actively participate in the management of the firm or not, are entitled to true accounts and full information of all the things affecting the partnership, including the secret profits derived by one partner at the expense of the partnership. A proper book of accounts should therefore be kept by one or more of the partners or by some subordinate, and each partner must be allowed convenient access thereto. A partner may even, without the permission of the others, make extracts from the firm books[43] provided that he is not actuated by an improper purpose, such as soliciting customers of the firm to patronize him in his individual competing business.[44]

74. **Right to carry on a separate business.**—A partner cannot carry on another business in competition or rivalry with that of the firm thereby depriving it of the benefit of his time, skill and fidelity without being accountable to his copartners for any profit that may accrue to him therefor; he cannot be permitted to secure for himself that which it is his duty to obtain, if at all, for the firm of which he is a member. To allow a partner to carry on or be interested in a business competing with the firm, would do violence to every obligation which he has assumed. No man can serve two masters. The inevitable consequence of any attempt to conduct a competing business must be a neglect and injury to the partnership business. A partner in a firm or-

[43] Taylor v. Rundell, 1 Younge & C. Ch. 128 (Eng.).
[44] Trego v. Hunt [1896], A. C. 7 (Eng.).

ganized for the purpose of locating and developing mining properties, must therefore account to the firm for all mines located by him during the partnership.[45]

While a partner may not engage in a competing business, he may, however, unless he has obligated himself to give his entire time to the partnership business, engage in business which is outside of the scope of the firm business. "Although a partner carries on a business for his private benefit which is similar to that of the firm, he will not be answerable to his copartners for the profits if the business is really different from that of the firm."[46] Thus a member of a firm of warehouse men does not compete with his firm in owning and manufacturing wharf boats.[47]

75. **Right to contribution.**—By contribution is meant the act of one or several common debtors in reimbursing one of their number who has paid the whole debt. Where A and B are liable to C, and A has paid the whole debt, it is just and fair that B should reimburse A for one-half of his outlay. The same situation may arise in a partnership. If A and B are partners they are jointly liable for all the debts of the firm. C, a creditor of the firm, however, may force A to pay the entire debt. This relieves B from liability as against C, but it does not relieve B entirely. B becomes liable to A to the extent of one-half of the payment made by A. Thus, where a firm

[45] Jennings v. Rickard, 10 Colo. 395.
[46] Burdick, Partnership (1st ed.), p. 310.
[47] Northrup v. Phillips, 99 Ill. 449.

debt is put into judgment, and execution is levied against the separate lands of the partners and these lands are sold, and one of the partners redeems them by paying the entire debt, such partner may hold his partner for one-half of the money paid by him.[48]

The right to contribution and indemnity, however, goes further than above indicated. "Every partner is entitled to be idemnified in account with the firm for payments and liabilities incurred by him, (a) in the ordinary and proper conduct of the business of the firm, (b) in or about anything done for the preservation of the business or property of the firm."[49]

Even where the partners have been wrong-doers the general rule of law that there is no contribution between wrong-doers will not be applied with full force. "The claim of a partner to contribution from his copartners in respect to a partnership transaction cannot be defeated on the ground of illegality unless the partnership is itself an illegal partnership, or unless the act relied on as a basis of the claim is not only illegal but has been committed by the person seeking contribution when he knew or ought to have known of its illegality."[50]

76. **Right to compensation.**—A partner is entitled to participate in the profits realized in a partnership business in the proportion agreed upon by the partners. Since he, by attending to the firm business, is conducting but his own affairs, he is not

[48] Downs v. Jackson, 33 Ill. 464.

[49] Shumaker, Partnership (2d ed.), p. 159.

[50] Adamson v. Jarvis, 4 Bing. 66 (Eng.).

entitled to any extra compensation unless a special agreement to that effect has been made, or unless extra trouble has been caused to him by his copartner's neglect of duty. Where the partnership agreement has provided for extra compensation of one or more of its members the agreement controls. This agreement may also anticipate such events as the death or sickness of a member and may provide a compensation to the other members for the extra work which will be caused to them by such event. If no such agreement is made, the sickness of a copartner will be considered as a risk which is incidental to the partnership relation and which is therefore assumed by all the partners. "Even where a liquidating or surviving partner settles up the business, it has been repeatedly held that he is not entitled to compensation for doing so, although in such case he performs all the services."[51] A different question arises where a partner wilfully neglects the business of the firm and thus throws an added burden on his copartner. The defaulting member should not be allowed to profit by his default. He has not been unfortunate as the partner who has fallen sick, but has wilfully omitted his duty to his copartner. Hence courts will allow the other partners a reasonable compensation for extra trouble caused to them by such neglect.

77. **Partner's lien.**—Whenever property, real or personal, is charged with a payment of a debt or duty a lien is said to rest on it. A mortgage is a familiar example of such a lien. It is created by the express

[51] Lindsey v. Stranahan, 129 Pa. 635, 18 Atl. 524.

agreement of the parties. There are, however, liens which come into existence without such express agreement. A mechanic's lien is an example. If a mechanic is not paid for the work he has done on a house he may go into court and eventually sell the house in order to satisfy his claim. A partner's lien is of a somewhat similar nature. Suppose A and B are in partnership, each having contributed $1,000. The partnership has not been successful. No profits have been realized but a debt of $1,500 has been contracted. A also owes an individual debt of $1,000 to C. He secures C by mortgage on his share of the partnership assets. B, the other partner, has the right to insist that the partnership debt be paid before the mortgage, although only $500 will be left after such payment, to be divided between A and B. C will thus obtain only $250 under his mortgage. "In settling partnership accounts each partner is clothed with the right to insist that the partnership funds shall be first applied to the payment of the partnership debts and this right will prevail over the claims of an alienee or a creditor of the copartners. So clearly defined is this right, so necessary to persons engaging in joint adventures of this kind, that it has been long and firmly settled that each partner has a lien on the effects that they shall be applied primarily to the extinguishment of the partnership liabilities."[52]

But a lien goes still further than this. "After the debts are all paid each partner has a lien on the remaining partnership effects for any balance due him

[52] Warren v. Taylor, 60 Ala. 218.

upon a proper accounting." This means that where one partner has drawn out more than his share of the profits, or has in any other way become indebted to the firm, his interest in the firm property "will stand encumbered by a lien to make good the deficit to his copartners." Thus, if on a final accounting between A and B, partners, it is found that A is indebted to the partnership to the amount of $500 and that the profits of the partnership are $1,000, the debt of A will be counted as partnership assets and each partner will be entitled to receive $750. The debt which A owes to the partnership will then be off-set against his $750 and he will receive but $250, while B will realize the full amount of $750.

78. **Distribution of assets among partners.**—It is obviously not an easy matter to wind up a partnership, particularly where it is large and involved. In general it may be said that the procedure is to ascertain, first, how the partnership stands towards third persons, and secondly, what each partner has brought in and what he has taken out. After this is done, it is possible to apportion the profits to be divided or losses to be made up, and to ascertain what each partner is to pay to the others in settlements or in cross claims. The accounting completed, the assets are distributed, first, in payment of debts due to third persons; secondly, in repaying to each partner what advances he may have made; third, in repaying to each partner the capital which he has invested, and fourth, in dividing the profits, if any, in the proportion provided by the partnership agreement.

CHAPTER VII.

REMEDIES OF CREDITORS.

79. Legal remedies of creditors of the partnership.—A partnership obligation is joint; that is, it is binding upon all the partners jointly.[53] When this joint obligation is converted into a judgment, however, it becomes also a several obligation; that is, the obligation of each individual partner, and may be satisfied out of the joint and the separate property of the partners. If A and B are partners and have $1,000 of separate property and also $1,000 of joint property, and a judgment is recovered against them on a partnership obligation, the judgment creditor may satisfy the judgment out of the joint property of both, or out of the separate property of either or both, or he may proceed against all the property of the partners, joint as well as separate.[54]

The usual method of enforcing judgments is by levying execution or actually taking the property of the debtor. Against such execution certain property is in most jurisdictions exempt. This question of exemptions becomes of great importance so far as the joint property of the partners is concerned. The exemption statute "is intended to apply only to the case of a single and individual debtor. The exemption which it gives is strictly personal."[55] The exemp-

[53] See §§ 47, 49, 50.

[54] Meech v. Allen, 17 N. Y. 300, LEADING ILLUSTRATIVE CASES.

[55] Hart v. Hiatt, 2 Ind. Ter. 245, 48 S. W. 1038.

tion would therefore have no application to partnership assets except in cases where the partnership has been dissolved and the partnership property has in fact become the separate property of the former partners.

80. **Attachment.**—Under certain circumstances special statutes allow a creditor to anticipate a judgment by attaching the property of the debtor. This remedy is a harsh and extraordinary one, and hence the statutes authorizing it will be construed strictly and will not be extended beyond their clear intent. Non-residence of a debtor, and misconduct, such as secreting or wasting his property or endeavoring to take it out of the jurisdiction, will generally constitute a cause for attachment. There is no doubt that individual property of a partner is thus subject to attachment. The question arises whether partnership property will also be subject to this harsh remedy. The courts answer this question by distinguishing between the case where only one partner is guilty of misconduct, and the case where all the partners are guilty. In the first case the remedy will not be applied because it would inflict an injury upon innocent persons. Where, however, all of the partners have acted in such a way as to become subject to attachment, there is no reason why the remedy should not be applied to them, and hence they will be held to be subject to attachment.[56]

81. **Legal remedies of creditors of the partners.**—A creditor of a partner will find no extraordinary

[56] Jaffray v. Jennings, 101 Mich. 515, 60 N. W. 52. See subject, ATTACHMENT AND GARNISHMENT.

difficulty in levying execution on the separate property of his debtor. His difficulty is simply that common to most judgment creditors, namely, to find enough non-exempt property to satisfy the judgment. When, however, he attempts to levy execution on the right of a partner in the partnership property he meets with many difficulties owing to the peculiar nature of these rights. Suppose the partnership of A and B has personal property worth $3,000 and debts amounting to $2,500. The real interest of the partners thus amounts only to $500. Now, suppose that C has a judgment against A. He cannot take B's part of the $500, but must be satisfied with A's part. In other words, he is entitled to only $250. But how is he to get at these $250? All the debts of the partnership must be paid before he can collect anything. Before all these debts are paid it is impossible to estimate exactly the value of A's interest. Yet, to pay all the debts may be impossible without winding up the business. It follows that the business may have to be wound up before C can satisfy his judgment out of the interest of A.

In addition to this fundamental difficulty of levying on the interest of a partner in partnership property, there is a further one. The courts are quite divided on the question of what property is to be seized under such an execution.[57] Some hold that all or part of the partnership property must be actually seized while others are satisfied with a mere constructive levy. When it comes to the sale of the prop-

[57] Johnson v. Wingfield, 42 S. W. 203 (Tenn.), LEADING ILLUSTRATIVE CASES; Gilmore, Partnership, p. 410.

erty thus levied upon of course only the share of the debtor can be sold. This would be quite simple where there are no partnership debts and advancements. Since there are usually debts, a resort to a bill in equity for an accounting to ascertain the actual value of each partner's share becomes necessary.

82. **Garnishment.**—Suppose A and B are in partnership and C is indebted to them on a partnership contract. D, an individual creditor of A, finds out about this situation and desires to obtain this money to satisfy his claim against A. The question is thus presented, whether the debt due to a partnership can be garnished to satisfy a claim against one of the partners. This question must be answered in the negative. "Such debt belongs to and is assets of the partnership, primarily liable to the satisfaction of partnership debts. If a judgment were given at law upon the garnishment proceedings against the debtor to the partnership to satisfy the separate liability of one of the partners, it would unjustly abstract a portion of the fund primarily belonging to the objects and purposes and creditors of the concern and in such a garnishment nothing can be done but to give or refuse the judgment."[58]

Where, however, tangible property of a partnership, such as animals or goods, wares and merchandise, is held by a third person, the courts have allowed the same to be garnished by the creditor of one of the partners. In this case the creditor acquires only the rights of his debtor to the property and must respect

[58] People's Bank v. Shryock, 48 Md. 427.

the rights of the creditors of the partnership and of the other partners.

83. **Remedies in equity—Means by which equity acquires jurisdiction of partnership affairs.**—Originally the power of equity was confined almost exclusively to matters involving a trust relation. Over trust and trustees the common law courts exercised no jurisdiction. Whatever remedies regarding them were invoked had to be invoked in equity. Hence, the case where a partner assigns to a trustee for the benefit of creditors gave occasion for the intervention of equity. But partners sometimes refuse to assign for the benefit of creditors, though their affairs are in a desperate state. In such case a creditor was allowed to come into equity and file his bill for an adjustment of the affairs of the insolvent firm. Equity may even acquire jurisdiction on a petition in insolvency on the part of one or more of the partners. The rules according to which the property of a partnership is disposed of in equity are somewhat different from those obtaining at law and will be the subject of the following sections.

84. **Priority of firm creditor's claim against firm property.**—Whenever a partnership goes on the rocks, the affairs of the individual partners are usually also in a sorry shape. There will be firm creditors and creditors of individual partners, and insufficient property to satisfy the demands of either or both. Hence the question of the priority of creditors is of great importance. In entering into a partnership contract the parties impliedly agree that the firm debts are to have preference over their indi-

vidual debts. This agreement will be enforced in favor of the firm creditors when the affairs of the partnership are brought into equity. Suppose two persons are partners and as such contract a debt of $1,000. They also each personally owe a debt of $1,000 to other persons. If the assets of the partnership amount to $1,500 there is clearly no sufficient fund to pay all the firm and individual debts. If the assets were equally divided the creditors of the firm and the creditors of the individual partners would each receive $500. Since, however, the partners have agreed that the firm debts are to have the preference, the firm creditor will recover the whole amount, while the individual creditors will have to be satisfied with $250 each.

If, however, a partner conceals his existence from the public and allows them to trade with his copartner as if he were the sole trader, the distinction between separate and joint debts will not be made. The dormant partner has by his conduct induced the creditors to rely on the credit of the ostensible partner by allowing him to pose as sole owner of the partnership property and has thereby estopped himself to deny such ownership. He now cannot complain if the firm property is taken for the debts of the ostensible partner and the firm creditors are in no better position. They expected to compete with the separate creditors when they contracted with the firm and will not be given a preference because they have discovered a dormant partner.

85. **Firm assets by estoppel.**—It is not always easy to know whether certain property is firm or

separate property. A partner may allow his separate property to be used for partnership purposes in such a way that everybody outside of the partners is lead to believe that such property is firm property. Under the English Bankruptcy Act of 1883 such firm will be treated as the reputed owner of such property and the property itself will be used to pay its debts. The same doctrine has been asserted in America but has been put upon the ground that the individual partners and their creditors are estopped under such circumstances to deny that such property is firm property.[59] Suppose A and B are partners. X allows his property to be used in such a way that creditors of the firm are led to believe that it is firm property. If credit is thereupon extended to A and B, X has placed himself in such a position that he cannot as against these creditors deny that such property is firm property. While the individual creditors have done nothing to estop themselves yet the courts hold that even as against them such property must be treated as firm property. But because of the injustice to the creditors of X, the real owner of the property, some courts hold that X's individual creditors may have payment out of such property before the creditors of the firm of A and B.

86. **Priority of separate creditor's claim against separate property.**—At law a firm creditor may, at his option, satisfy his claim out of the firm or out of the individual property of the partners. A different rule obtains in equity. If equity has taken hold of a partnership, the firm creditors, being preferred in

[59] Thayer v. Humphrey, 91 Wis. 276, 64 N. W. 1007.

regard to firm debts, are postponed in regard to claims against the separate property of the partners. The common law right of firm creditors is thus abridged. "With what semblance of equity could one class of creditors, in preference to the rest, be exclusively entitled to the partnership funds, and concurrent with the rest, entitled to the separate estate of each partner? The joint creditors are no more meritorious than the separate creditors, and it frequently happens that the separate debts are contracted to raise means to carry on the partnership business."[60] Where, therefore, the affairs of a partnership have been brought into the equity, the separate creditors will as a general rule have a priority over the firm creditors as far as the separate estate of the debtor is concerned. It is only just that since the firm creditors have a priority in regard to firm property that the separate creditors should have a similar right in regard to separate property.

87. **Same subject—Exceptions.**—The rule stated in § 86 is subject to certain exceptions. The partners may have no firm property or there may be no living solvent partner. In this case the firm creditors will have no preference, and consequently the individual creditors should have none. All will be treated alike in the distribution of the individual property of the partners. Or one of the partners may have fraudulently appropriated firm property and may thus have increased his individual property. To postpone firm creditors under these circumstances would be unjust. "Where you have a conversion of the property of the

[60] Rodgers v. Meranda, 7 Ohio St. 179, LEADING ILLUSTRATIVE CASES.

firm to the purposes of the individual members, not by way of contract or agreement with the firm, not within the knowledge or the cognizance of the firm, but by fraud of an individual partner to which the firm is no assenting party, of which its other members are not cognizant, there the reason for the rule ceases and the firm whose assets have thus been fraudulently abstracted, ought not to suffer and ought not to be deprived of the right to proceed against the separate estate in competition with any other claimants."[61] A further exception is made in England in regard to debts of a partner to a firm in respect to a separate trade carried on by him. An exception of this kind, however, is full of embarrassment and difficulty and is in conflict with the simple and direct mode of distribution of joint and separate assets.[62]

88. **Remedies of secured creditors.**—One of the creditors of a firm may have taken collateral security. A creditor who is thus secured has a double concurrent remedy. For example, A has a note of $1,000 signed by X and Y as partners. He has also as security, for the payment of this note, a mortgage on the property of the firm. He may satisfy his claim by foreclosing the mortgage or he can prove his claim against the partnership estate and receive a dividend along with the other and the unsecured firm creditors. He can do both things at the same time. Of course if the whole debt is $1,000 and he realizes $800 by one method he will be allowed to realize only $200 by the other method. "The collateral is security for

[61] Read v. Bailey, 3 App. Cas. 94 (Eng.).
[62] Somerset Potters Works v. Minot, 10 Cush. 592, 598 (Mass.).

the whole debt and every part of it is as applicable to any balance that remains after payment from other sources as to the original amount due."[63] A different rule, however, has been adopted in the bankruptcy courts.[64] According to the bankruptcy rule the security must be surrendered or sold before the principal debt can be realized upon. A similar doctrine has been adopted in some states in connection with their insolvency laws.[65]

89. **Remedies of joint and several creditors.**— Where a note or other obligation is signed by a partner in the partnership name and is also signed by the partners individually a joint and several obligation is said to arise. That is to say, the creditor may enforce this obligation against the partnership or against the partners or against both. Where such a partnership or some or all of the partners become insolvent the question arises whether a joint and several creditor can file a claim against the partnership and against the partners. The English courts have denied the right of such a joint and several creditor to this double remedy, and have forced him to elect to claim either under the joint or the separate obligation. In America, however, a different rule has been adopted. As said in a Maine case, "A joint and several note contains in one instrument two contracts separate and distinct from each other. The makers promise as a firm and also as individuals. In a legal sense the parties to the two contracts are not the

[63] Merrill v. National Bank of Jacksonville, 173 U. S. 131.
[64] Same case in note 63.
[65] Amory v. Francis, Adm'r, 16 Mass. 308.

same but different parties. The parties meant something by this form of double contract. The holder intended to have a security upon more than one estate. * * * He might have taken separate notes for the same debt. Why not let the same thing be simply and directly done."[66] Where, however, under this rule a creditor has received a dividend from one fund he will be entitled as against the other fund only to the amount by which the claim exceeded the dividends received from the first fund.[67]

90. **Partner's claim against copartner's estate.**—A partner who has become insolvent may owe a separate debt to his copartners. The question arises whether his copartners can prove this separate debt against the estate of their insolvent partner. This question will generally receive a negative answer. It must be remembered that the creditors of a partnership are at the same time the creditors of each partner. The firm creditors may therefore prove their claim against the estate of any one of the partners without losing their right to go against the firm as such. If a partner were allowed to prove a claim against his copartner he might thus come in competition with the firm creditors and thereby diminish the amount which these firm creditors are entitled to realize out of the separate estate of the insolvent partner.[68] Of course where there are no firm creditors or where credit extended to the firm has been paid by the partners this reason ceases to exist and

[66] Ex Parte Nason, 70 Maine, 363, 367.
[67] Hawkins v. Mahoney, 71 Minn. 155, 73 N. W. 720.
[68] Ex Parte Topping, 4 De Gex. J. & S. 551, p. 556 (Eng.).

one partner under those circumstances, may prove a claim against the estate of his copartner. Another exception to the general rule above stated is where the separate estate of a partner is so small that his separate debts cannot be paid out of the same. Since these separate debts have the preference over the claims of partnership creditors, it would follow that the partnership creditors would be in no position to make effective their claim against the estate of the insolvent partner. Under these circumstances the solvent partner and the creditors of the partnership cannot come into competition, and the reason for the general rule above ceases. "If it be true that the estate of the partner against which the proof is tendered cannot by any possibility yield a surplus it would be unreasonable and unjust to refuse an opportunity of proof being made."[69]

91. **Bankrupt or insolvent partner.**—Where one partner becomes bankrupt while his copartners remain solvent, the older cases tend to treat the solvent partner and the trustee of the insolvent partner as tenants in common of the firm assets, and allow them to hold the property as such tenants in common. It would follow that where the solvent partner is in possession of the firm assets such possession will not be disturbed in favor of the assignee of the insolvent partner unless for good cause shown. On the other hand if the assignee of the insolvent partner is in possession he will not be disturbed in favor of the solvent partner except for good cause.

The more modern view, however, tends to regard

[69] Same case in note 68.

a bankrupt partner very much like a deceased partner[70] and to give the solvent partner the right to manage the partnership property. This principle was expressly recognized in the United States Bankruptcy Law of 1898 as follows: "In the event of one or more, but not all, of the members of a partnership being adjudged bankrupt the partnership property shall not be administered under bankruptcy unless by consent of the partner or partners not adjudged bankrupt, but such partner or partners not adjudged bankrupt shall settle the partnership business as expeditiously as its nature will permit and account for the interest of the partner or partners adjudged bankrupt."[71]

92. **Deceased partner.**—Where a partner dies leaving separate debts, while the partnership also is indebted, the question, which of the two classes of creditors, if either, is entitled to a preference out of the estate of the deceased, becomes important. Where there is no joint estate and no living solvent partner, the partnership creditors will be in no better position than are the individual creditors of the partners. Their only chance of recovering all or any part of their claim will be against the estate of the deceased partner. The courts are agreed that under these circumstances both the individual and the firm creditors will participate equally. Where, however, there is partnership property or a solvent surviving partner, a different situation arises. The partnership creditor, aside from his right against the estate of

[70] See § 92.

[71] Bankruptcy Act of 1898, chap. 3, § 5.

the deceased partner, may realize all or part of his debt out of the firm property, or from the solvent partner. He is, therefore, in a better position than the individual creditors of the deceased partner, who have nothing but the estate of their debtor to satisfy their claim. To equalize this inequality, the courts in England and in some of our states allow the individual creditor to satisfy his entire debt out of the estate of his debtor before the partnership creditors will be entitled to anything. Some jurisdictions in the United States, however, go further and hold that a firm creditor, in order to be entitled to file his claim against the estate of the deceased partner, must make a showing that the surviving partners have been proceeded against to execution, or that they are insolvent, before he will be allowed to file his claim against the estate.

CHAPTER VIII.

ACTIONS BETWEEN PARTNERS.

93. **General theory.**—Partners may have difficulties with each other and may find that a peaceable settlement of these difficulties is impossible. Resort to the courts thus becomes necessary. In going into court, however, numerous difficulties await them, owing to the peculiar development through which the English law has passed. Originally the rights of Englishmen were enforced in what were known as common law courts. These courts had developed a number of so-called forms of actions. These forms, while at first pliable, soon became fixed. A suitor had to get his case under one of them or he would be without a remedy. This led to great hardship. Many cases would not fit the forms of action. An appeal was, therefore, taken to the king. The king being engaged in other matters, would refer these appeals to his chancellor. The chancellor in turn would attempt to do justice between the parties, independent of their common law rights. From this beginning courts of equity have developed. Their purpose was not to supersede the common law, but to supplement it. A long-drawn-out war between the two systems soon developed. In the end peace was effected and the two systems of law continued to grow side by side. In recent times they have generally been administered by the same judges. Modern statutes

have even attempted to wipe out all distinction between them, but these distinctions are still in existence and have their influence on actions between partners.

94. **Actions at law.**—Difficulties in accounting among each other for profits and losses are the most frequent sources of trouble between partners. The old common law had developed an action of accounting. This action, however, has never been used very extensively, owing to the difficulty, expense and delay connected with it. An attempt to adjust partnership affairs through it has been made in the state of New York, but has failed completely.[72] But even outside of the difficulties attending this particular form of action there is a technical and a real difficulty which prevents one partner from suing the other partners at law. Partnership obligations are joint, which means that all the partners must be joined as defendants in an action to enforce them. If A, B and C are in partnership and A wants to enforce a partnership claim against B and C, he would not be allowed to sue simply B and C, but would have to join himself as defendant. The result would be an action of A against A, B and C. A, in other words, would sue himself, which is an impossible situation. A more substantial reason for the rule that partners cannot settle difficulties between themselves in a court of law is the fact that, no matter how much profit may have been realized by the firm, no one partner is a debtor of the other partners until after an account

[72] Jacobs v. Fountain, 19 Wend. 121 (N. Y.), Appleby v. Brown, 24 N. Y. 143.

is had. Until such time the profits belong to the partnership rather than to the partners. "Till a full accounting is had it cannot be ascertained or declared what portion of such claims belong to the one or the other."[73]

95. **Same subject—Exceptions.**—The rule that partners cannot sue each other at law is not without real and apparent exceptions. Where partners have dealt with each other in matters outside of the partnership they may maintain actions against each other in regard to such matters. If A and B are partners, that fact does not prevent one from suing the other for the price of separate property sold by one to the other.[74]

The mere fact that a partnership has at one time existed between the parties will be no objection to a suit brought by one against another, even though this suit is connected with the former partnership business. "Where there is an agreement adjusting partnership affairs and that agreement awards to one partner a specific sum or creates a specific duty in his favor he may maintain an action upon the breach of the duty or promise."[75]

The two cases above mentioned are really only apparent exceptions to the rule that a partner cannot sue the other partner at law. There are, however, some real exceptions. Partners may make contracts with each other as individuals in regard to the partnership business. A may agree to form a partner-

[73] Ledford v. Emerson, 140 N. C. 288, 52 S. E. 641.
[74] Hartzell v. Murray, 224 Ill. 377, 79 N. E. 674.
[75] Douthit v. Douthit, 133 Ind. 26, 32 N. E. 715.

ship with B and to advance money to B, which money is to be used as B's share of the partnership capital. If A breaks his contract to advance this money B may sue him on the same, even though the partnership may already have been launched. "An agreement to pay money or to furnish stock for the purpose of launching a partnership is an individual engagement of each partner to the other and the defaulting partner may be sued in an action at law upon his agreement. It is entirely separate and distinct from the partnership account."[76]

Some courts have even gone further than this. They have actually allowed partners to litigate actual partnership matters at law between themselves. A partnership may be fully wound up except in regard to one item of the account, or the partnership may have been formed for but a single transaction. Under such circumstances the question before the court will be a very simple one. Hence, some courts have held that such questions may be litigated between the partners at law.

96. **Actions at law between partners after final settlement.**—Where a final settlement had been effected between partners, either by agreement or by a decree of a court of equity, the respective rights of the various partners are adjusted and the partnership is at an end. If either of the former partners thereafter fails to comply with the terms of the agreement or with the terms of the judgment, there can be no objection to a suit of the other partners against him.

[76] Cook v. Canny, 96 Mich. 398, 55 N. W. 987.

97. **Actions between firms with common member.**—It often happens that one person is a partner in two distinct firms. Sometimes these firms will get into difficulty with each other so that a lawsuit becomes necessary. The difficulties that await the litigants under these circumstances are all but insuperable. The courts are unanimous that no action at law can be maintained under these circumstances, since in an action at law the common member of the firm would be obliged to sue himself. On the question whether equity has power to maintain such a suit, the cases are divided. Some courts in effect treat the partnership as a separate entity and allow the suit to be carried on.[77] Other courts, however, hold that a dissolution of both partnerships and a mutual accounting is the only remedy that will do complete justice between the parties, and will not allow the two partnerships to engage in litigation.[78]

98. **Actions between partners under the code.**—During the middle of the 19th century a movement to reform legal procedure started in New York and swept across the country. Many of the states abolished the old common law system of pleading and adopted the code system. One court of justice was substituted in place of the courts of equity and of law. The distinctions between legal and equity actions were abolished, in form at least. But, while the form and course of proceedings were greatly changed, "the principles by which the rights of the parties are to be determined remain unchanged. The code

[77] Cole v. Reynolds, 18 N. Y. 74; Bates, Partnership, § 905.
[78] Rogers v. Rogers, 40 N. Car. 31; 5 Am. Law Review, 47.

has given no new cause of action. In some cases parties are allowed to maintain an action who could not have maintained it before, but in no case can such an action be maintained where no action at all could have been maintained before upon the same state of facts."[79] Thus, one partner cannot, under the code, maintain an action against his copartner for money due on an unsettled partnership account.

99. **Actions in equity between partners—General theory.**—Courts of equity were instituted and developed to supplement, not to supersede, courts of law.[80] Hence, it is a fundamental principle of equity that where a legal remedy is adequate equity will not interfere. In all those cases in which one partner can vindicate his rights at law he will not be allowed to obtain any relief in equity. On the other hand, it may be generally said that where the legal remedy is inadequate, equity will supply the defect.[81] However, even equity will adhere to certain fixed rules in dispensing justice. It will not settle all partnership squabbles arising from various causes, such as passing improprieties and defects of temper, but expects a certain amount of forbearance and good feeling from each partner. Neither will equity act if the complainant has slept on his rights. It sometimes happens that one of the partners of a speculative venture allows his copartners to do all the work and shoulder all the responsibilities. If the venture proves to be a failure he will never be heard of. If,

[79] Cole v. Reynolds, 18 N. Y. 74, 76.

[80] See § 93.

[81] Bracken v. Kennedy, 4 Ill. 558, LEADING ILLUSTRATIVE CASES.

however, it proves to be a success he comes forward and urges his claims as a partner. Such a position is unfair and inequitable, and hence a court of equity will not give any support to it. Another principle on which courts of equity have acted is not to interfere with a partnership except with a view to dissolution. This rule, however, has been greatly relaxed in modern times.[82]

100. **Accounting upon dissolution.**—It is obvious that a partner has a right to an account from his copartners at any time and particularly upon the dissolution of the partnership. This right is of great importance. Without it, it may not be possible to say whether a partner is a debtor to or a creditor of his copartners. Such an accounting may be and usually is had by the voluntary action of the partners. Sometimes, however, it is not possible for partners to agree upon any such voluntary action. In such cases it is well settled that the courts will, in an action to dissolve the partnership, force an equitable accounting between the partners, even though the accounts are not complicated.[83]

101. **Accounting without dissolution.**—At one time it was a fairly well settled rule of equity practice not to force a partner to account unless the accounting was sought in connection with an action to dissolve the partnership. This rule rested on the consideration that as soon as the partnership affairs had reached such a stage that an account had to be enforced by the courts the only adequate solution of

[82] Gilmore, Partnership, p. 492.

[83] Cruikshank v. McVicar, 8 Beav. 106 (Eng.).

the difficulty between the partners was a dissolution of the firm and a final accounting. Says Parsons: "A partner who is driven to a court of equity as the only means by which he can get an accounting by his copartners, may be supposed to be in a position which will be benefited by a dissolution. In other words, such a partnership as that ought to be dissolved."[84] However, it was soon felt that equity would do more injustice by refusing to do less than complete justice, than could arise by interfering only to the limited extent desired by the suitor. Hence, numerous exceptions have been made to the rule above stated. These have been summarized as follows: "First, where one partner has sought to withhold from his copartner the profits arising from some secret transaction. Second, where the partnership is for a term of years, still unexpired, and one partner has sought to exclude or expel his copartner or drive him to a dissolution. Third, if the partnership has proved a failure and the parties are too numerous to be made parties to an action and a limited accounting will result in justice to them all."[85] An exception is also made where the interest of a partner has been seized on execution or attachment by his individual creditors. In such a case only the interest of the one partner is attached and the courts will lend their aid to determine what that interest is at the time of the attachment, and in order to do so will bring about a limited accounting.[86]

[84] T. Parsons, Partnership (4th ed.), § 206.
[85] Lord v. Hull, 178 N. Y. 9, 70 N. E. 69.
[86] Cropper v. Coburn, Fed. Cas. No. 3416 (U. S.).

102. **Specific performance.**—If A enters into a contract with B and B breaks this contract, A may sue B for damages. Or if the damages are inadequate he may in many cases invoke the aid of equity to force B to perform the contract according to the precise terms agreed upon. It is obviously impossible, however, to control feelings by a court decree. Now, a partnership relation involves mutual good will between the partners. No decree of a court can restore or create such good will. To force persons into a relation of mutual confidence, though there is no mutual confidence, is an impossible task which courts will not undertake. Hence, courts will not force persons who have agreed to form a partnership to do business as partners. They will go no further than to decree in certain cases that a partnership has come into existence. Suppose that certain persons have agreed to purchase, improve and sell land. They actually purchase and improve the land and then deny the right of one of them to any share in the profits. The courts will, in such circumstances, decree that a partnership exists and will then dissolve the partnership and distribute the profits among the partners.[87] So, also, the courts may decree that a partnership exists for a fixed term where this is necessary and confer certain rights upon one of the parties to the contract.[88]

103. **Injunction.**—An injunction is an order of a court requiring a person to do or to refrain from doing some particular act. It is a very efficacious

[87] Dale v. Hamilton, 5 Hare. 369 (Eng.).
[88] England v. Curling, 8 Beav. 129 (Eng.).

method of forcing to terms a partner who is exceeding his rights. Oftentimes a partner will act in such a way that it becomes necessary to curb him, while it is not desirable to dissolve the partnership. Under these circumstances equity will interfere by injunction. By enjoining the party bent upon mischief, the court does not take the affairs of the partnership into its own hands, but only restrains one or more of the partners from continuing to act in the way complained of.[89]

104. **Receivers.**—A receiver will be appointed by a court at the request of one of the partners to receive the rents and profits of the partnership business, when it does not seem reasonable to a court that the partners should receive them. He may be appointed before or after a dissolution of a firm, whether that dissolution is by agreement or by decree. He may even be appointed where no dissolution of the relations is contemplated, but where a receiver is necessary to preserve the firm property until the final hearing. Generally, however, he will not be appointed unless the dissolution is sought. It must be remembered that by appointing a receiver a court takes hold of the business of the partnership. A court is reluctant to thus enter into business except where the case is one of absolute necessity. When a receiver is asked for before a dissolution is effected it must appear that the plaintiff will be entitled to a decree of dissolution and that the defendant has been guilty of improper conduct before such a decree will be made, and if the receiver is asked for

[89] Gilmore, Partnership, p. 514.

after dissolution is actually effected, the courts will refuse to appoint him unless it appears that the assets of the firm are imperiled and that a partner is misconducting himself.

CHAPTER IX.

ACTIONS BETWEEN PARTNERS AND THIRD PERSONS.

105. **Parties plaintiff in actions by the firm on contract in firm name.**—Since a partnership is not a distinct legal person, it cannot as such be a plaintiff to a lawsuit. In a few states, however, it is provided by statute that a partnership may sue and be sued in the firm name. Unless changed by statute, therefore, the lawsuit must be by the individual members of the firm. Where A and B are in partnership under the name of A and Co., the suit for a partnership obligation is properly brought by A and B, copartners, under the name of A and Co. It would not be proper to sue simply under the name of A and Co.

A contract made in the name of the partnership is a contract made with all of the partners jointly and hence all must join in an action to enforce it. An exception exists in the case of dormant and nominal partners. Dormant partners are partners who are not known to the world to be partners at all. The person who contracted with a partnership does not know of them. Hence, they may or may not join as plaintiffs in a suit on a partnership contract. A nominal partner is the reverse of the dormant partner. He appears to the world to be a partner, but is not such in fact. Whether he must join or be joined in an action is a matter of great difficulty. Where the contract is made expressly with him as a real part-

ner he must be made a party. Where the contract is made with the firm of which he is a nominal member without his personal interposition he need not be joined. There are also cases where courts hold that a nominal partner cannot be joined.

106. **Parties plaintiff in actions on contracts in the individual name of a partner.**—A partner will sometimes make a contract on behalf of the partnership, but in his individual name. The general rule is well established that a suit on such a contract must be brought in the name of all the persons who were partners at the time when the contract was made. This rule, however, is subject to numerous exceptions. One of the partners may give or take a deed of land, or a note, check or draft in his own name. The person with whom he deals may expressly refuse to deal with the other partners, or the circumstances surrounding the deal may be such as to show that the contract was with the partner personally and with him alone. Everyone has a right to elect what parties he will deal with.[90] In all such cases suit must be brought in the name of the individual partner with whom the contract was made. "If one partner makes a contract in his individual capacity and the other partners are willing to take the benefit of it, they must be content to do so according to the mode in which the contract was made."[91]

A contract may be made by a partner in such a way as to bind both the partner individually and the firm collectively. "An agent may and often does

[90] Winchester v. Howard, 97 Mass. 303.

[91] Lucas v. De la Cour, 1 Maule. & S. 249 (Eng.).

make himself a party to the contract. If the form of the contract be such as to amount to saying: 'Although I am an agent only, nevertheless I contract for myself,' and although the principal may in some cases take advantage of such a contract, the agent, being the contracting party, is clearly liable and can, therefore, sue upon it."[92] Or a person may act ostensibly for himself, while in fact he is acting for the firm, whose remaining members are dormant. Or one partner may pay out firm money by fraud or mistake. In all such cases suit may be brought by all the partners or by the individual partner who made the contract, or paid out the money. It must be noted, however, that in all such cases where either the firm or the individual may sue, the firm may supersede the right of its individual member to bring action. If, however, they choose to thus supersede the agent to sue, they will have to stand in the shoes of the member who made the contract and any defense which would have been available as against such individual member will be available as against the partnership.

107. **Parties plaintiff in tort actions.**—A tort is a legal wrong, independent of contract, committed upon a person or property. It may be committed against one person or against a number of persons. Suppose A and B are in partnership. C, a newspaper man, writes an editorial in which he wrongfully charges the firm with swindling. Both A and B personally suffer damage, while the firm business is also affected by the charge. It follows that the firm

[92] Fisher v. Marsh, 34 Law J. Q. B. (N. S.) 177 (Eng.).

will have an action of libel against C, but since A and B have also personally suffered damages, it would not be just to deny them the right to recover. It follows that three rights of action arise out of the publication of this one libel. A and B may each recover the damages which they have suffered, and may in a joint action recover the damages which they have suffered as a firm. C thus is liable to one suit by A, to another by B, and to still another at the hands of A and B. From the foregoing discussion it must be clear that where the tort is committed against a number of persons who are partners, the damages suffered by these persons as partners must be recovered in a joint action, while damages suffered by the persons as individuals must be recovered in separate suits.

108. **Parties defendant in contract actions against the firm.**—As has just been pointed out, a firm as such cannot be a plaintiff. It follows that it cannot as such be a defendant. Instead of suing or being sued in the firm name, all the partners must be joined as parties plaintiff or parties defendant. Thus, if A, B and C are in partnership under the name of A, B and C, all should be joined as defendants in an action against the firm of A, B and C. Suppose, however, the name of the firm is A, B & Co. C is a dormant partner whose existence is not known to the world. The creditor who attempts to sue the partnership may know nothing of the existence of C. Hence, it is held that C, being a dormant partner, need not be joined as a defendant. However, if the creditor so chooses, he may properly join C as a defendant. Sup-

pose, further, that A is only an ostensible partner. As such he will be estopped to deny any liability on his part if the creditor did not know at the time when the contract was made that he was only an ostensible partner. If, however, the creditor knew at the time of the contract that A was not an actual partner, he "cannot join him in an action against the firm, for the rule which imposes on a nominal partner the responsibilities of a real one is framed in order to prevent those persons from being defrauded or deceived who may deal with the firm."[93] In the case just supposed, the creditor may, therefore, have his option to either sue B alone or join with him A or C, or both.

There are, however, some cases where a partner must be sued individually, though he may have acted for the firm. Such are cases where the partner has given a deed or a note, draft or bill of exchange in his own name or where credit has been extended exclusively to him. We have seen in a previous section that the other partners cannot sue on such a contract. It follows logically that they cannot be sued on such a contract.

109. **Parties defendant in tort actions against the firm.**—Most wrongs outside of breaches of contract committed by a partner would not render his copartners liable to an action. There are, however, some wrongs which will make all the partners liable. Suppose A, B and C are in partnership as draymen. If they employ a servant to run one of their wagons they would be responsible for any injury negligently

[93] Dicey, Parties (2d Am. ed.), p. * 270.

inflicted upon some third person. They are equally responsible if the injury is inflicted by one of the partners. The partner who inflicted the injury would be individually liable, but his copartners would also be liable. The injured person could sue either the one partner or all of the partners. If, however, an action is brought against persons in respect to injuries to their common interest in land, a different rule would apply. In such cases all the partners must be joined.

110. **Effect of admission of new member.**—New partners are frequently admitted into old firms. Such admission in reality destroys the old firm and creates a new one. It does not, however, of itself affect the debts and credits of the old partnership. To enforce such debts the old partners must still join or be joined as plaintiffs or defendants, as the case may be. However, the creditors or debtors of the firm may agree that a new partner shall be substituted for the retiring partner.[94] If this is done, the debt or credit ceases to be an obligation against or a right in favor of the old firm, and is transferred over to the new firm. Thereafter the members of the new partnership will be the proper parties in an action to enforce the debt or credit.

The members of the old firm may also formally assign their claim to the members of the new firm. In such cases the members of the new firm will be the proper parties plaintiff in those states in which the assignee can sue in his own name. In those states, however, in which the assignee must still sue in the

[94] See § 52.

name of his assignor, the old partners will be the proper parties plaintiff or defendant.

In many states a contract made between A and B for the benefit of C is enforcible by C. Suppose that A is the old partner and B the new partner, while C is the debtor of the old partner. If B agrees with A to assume A's obligation C may sue B on this contract and recover. He may also sue A, the old partner.

111. **Effect of retirement of old member.**—Much the same considerations apply to the case where a partner retires from a firm as apply to the case where a new partner is added. No change is wrought in regard to the obligations of the old firm as against their debtors. If the old firm has credits outstanding which it is desired to enforce by action, all the former partners must join as plaintiffs. Conversely, if the old partnership has contracted debts which it is desired to convert into judgment, all the former partners must be joined as defendants. The exceptions to this rule are the same that exist in the case of a new member. The new partnership may be substituted for the old partnership, and in that case the new partners must be joined as plaintiffs or defendants, as the case may be, or a debt of the old partnership may be assigned to the new partnership and then the action should generally be in the name of the members of the new partnership. Where the new firm has assumed the debts of the old firm the creditors of the old firm may either sue the members of the old or of the new firm to enforce this obligation.

112. **Effect of death of member.**—Upon the death of a partner actions by or against the firm on joint contracts must be brought in the name of the surviving partner or partners. If all the partners have died it must be brought by or against the administrator or executor of the last surviving partner. Suppose "A joint contract is made by X, Y & Z. The liability to be sued upon the contract passes on the death of Z to X and Y; on the subsequent death of Y, to X; and on the death of X (provided the liability to be sued survives), to X's executor or administrator. The representatives of Z, for example, can neither be sued upon the contract themselves nor be sued jointly with X and Y."[95] Whenever, however, the liability "is several as well as joint, an action may, it is apprehended, be brought by or against the surviving partners and the executors or administrators of the deceased partner."[96]

113. **Effect of bankruptcy or insolvency of member.**—A partnership or an individual partner or both may become bankrupt or insolvent. If the firm itself becomes insolvent, actions to enforce claims against outside persons must be brought by the trustee appointed to administer its affairs. The courts are divided on the question as to who must sue in case some of the individual partners only become bankrupt. Most courts hold that the solvent partner and the trustee of the insolvent partner must be joined. Other courts, however, regard insolvency as the equivalent to death, and, therefore, regard only the

[95] Dicey, Parties (2d Am. ed.), p. * 238.
[96] Lindley, Partnership (5th ed.), p. 288.

solvent partner or partners as the parties plaintiff to an action.

Where an action is contemplated against a bankrupt partnership or a bankrupt partner, the central question is always, has the obligation been discharged or not? So long as a debt of a partnership has not been discharged in the proceedings the individual partners are liable on it. As soon, however, as a discharge is had, the right to bring an action on the debt is extinguished and the partners are freed from it. If one of the partners only goes through bankruptcy proceedings and is discharged, no action on a firm contract will therefore be maintainable against him. The action must be brought against the solvent partner or partners.

114. **Effect if one partner is disqualified to sue.**— In an action at law by a partnership all the partners must join as plaintiffs. If one partner is a citizen of a foreign country which is at war with the country in which suit is brought, he is disqualified to sue. Here a peculiar difficulty arises. Whenever "one partner is disqualified to sue upon a cause of action, no action can be maintained at law, either by all the partners jointly, because by hypothesis one is disqualified, or by the other partners, because all must join."[97] There is, therefore, no way in which such a partnership can get into court, for if all the partners join, the defendant will plead the disqualification of one, and if all but the disqualified partner sue, the defendant will object that all should be joined.

The situation becomes a serious one where one of

[97] Gilmore, Partnership, p. 560.

the partners has wrongfully disposed of firm property or has used firm property to pay his own debts. If the firm attempts to recover such property the defaulting partner will have to be joined as a plaintiff, for this is obviously a firm claim. Yet he is disqualified to sue because courts will not allow him to repudiate his former act. Where his wrongful act was done in the course of the partnership business, the situation is clear, for such act binds his copartners and they will all be disqualified to sue. Hence, no action can possibly be maintained.

If a defaulting partner has given a firm check or draft to his individual creditor in payment of his individual debt the individual creditor, however, will have to come into court as the plaintiff and enforce the payment of the paper. He will have to bring the partners into court as defendants. While the defaulting partner will have no defense, there is no reason why the innocent partners should not set up any defense which they may have. If, therefore, the plaintiff is not a holder in due course, if he knew or should have known that the paper was given fraudulently or without authority, the innocent partners may set up such facts in defense and defeat the plaintiff's claim.[98]

It is, therefore, in cases where the wrongful act was not done in the course of the partnership business, and the partners come into court as plaintiffs, that the great difficulty arises. The courts are divided as to whether an action at law can be maintained under these circumstances. Some hold that

[98] McConnell v. Wilkins, 13 Ont. App. 438 (Can.).

it cannot, for the reason stated above.[99] The hardship imposed by such a rule, however, has led other courts to break away from it. Judge Story, in Rogers v. Batchelor, said that in such cases the true question was whether the title to the property had passed from the partner to the separate creditor. If it had not, the partnership might reassert its right to the same. "In the case of a partner paying his own separate debt out of the partnership funds, it is manifest that this is a violation of his duty and of the rights of his partners unless they have assented. The act is an illegal conversion of the funds and the separate creditor can have no better title to the funds than the partner himself had."[1]

115. **Actions in firm name.**—A number of states have, by statute, provided that actions against a partnership may be brought in the partnership name either generally or where the names of the partners are unknown. These statutes do not introduce any new principle into the law of partnership, nor do they recognize a partnership as a separate entity or person. The partners may still be sued in their individual names or in their firm's name, at the option of the creditor. These rules, it will be observed, do not introduce anything that amounts to the recognition of the firm as an artificial person distinct from its members. They allow the name of the firm to be used for the purpose of making procedure quicker and easier and creditors of a firm have now the great practical convenience of being able to pursue their

[99] Jones v. Yates, 9 Barn. & C. 532 (Eng.).
[1] Rogers v. Batchelor, 12 Pet. 221 (U. S.).

claims, even to judgment, without first ascertaining who all the partners are. The substantive results, however, are the same as under the former practice.[2]

[2] Pollock, Digest of the Law of Partnership (5th ed.), pp. 23-28, 139-146.

CHAPTER X.

TERMINATION OF A PARTNERSHIP.

116. **Termination of a partnership—General theory.**—A partnership may die a natural death by the expiration of its own time limit or by the accomplishment of the purposes for which it was formed. It may come to an end by such events as the death or bankruptcy of a partner, and in such cases is said to be terminated by operation of law. It may also be terminated by mutual agreement between the partners, or even by the arbitrary action of any one of them. In extreme cases where unbearable conditions have arisen, it will be dissolved by the courts, just as the marriage relation may be dissolved.

117. **Termination by operation of law.**—By operation of law is meant the deduction which the law makes from established facts. Thus, from the mere fact of the death of a father the law deduces a right of his children to inherit his property. This deduction is entirely independent of the will of the father. He may have died without knowing that his children would inherit his property, yet, unless he has made a valid will in which he gives his property to other persons than his children, the legal consequences of his death will ensue, regardless of his own mental attitude in the matter. So, also, a partnership, while it can be created only by the act of the partners, may in various ways be dissolved by mere operation of

law. Upon the mere happening of certain events, such as death or bankruptcy of one of the partners, the law decrees that a partnership is at an end, whether the partners agree with such conclusion or not.

118. **Same subject—Death.**—The death of a partner instantly dissolves a partnership, just like the death of a husband or wife instantly dissolves a marriage. Where A, B, C and D are in partnership and D dies and thereafter C signs a note in the partnership name, A and B will not be liable on the same, since by the death of D the partnership was dissolved by operation of law before the note was executed.[3] And it is immaterial whether the partners are few or many. If a partnership consists of ten persons, the death of one will dissolve it. If the remaining nine conclude to carry on the business, they do not continue the old partnership, but create a new one. Even a stipulation in the partnership agreement that the death of one partner shall not dissolve the partnership, does not change the rule. "All these agreements and arrangements and all that can be done for a similar purpose are in fact only bargains for the creation of a new partnership when the old one ceases to exist."[4]

119. **Same subject—Bankruptcy.**—A bankrupt is a person who has done some act or suffered some act to be done in consequence of which he is liable to be proceeded against by his creditors for the seizure and distribution among them of his entire property. A

[3] Marlett v. Jackman, 3 Allen 287 (Mass.).
[4] Kennedy v. Porter, 109 N. Y. 526, 17 N. E. 426.

bankrupt loses all control over his property and the same passes to his assignee in very much the same way as the property of a deceased person passes to his executor or administrator; hence the bankruptcy, like the death of a partner, dissolves the partnership by operation of law.[5]

120. **Same subject—Partner disposing of his interest.**—If a partner conveys away his entire interest in the partnership property, he does by his own hand what the law does in case of his death or bankruptcy. The person to whom he assigns takes his property very much the same as an administrator or executor takes the property of a deceased person. He takes the place of the partner so far as his property interests are concerned. To hold that the partnership still continues would mean the substitution of the person to whom the property has been assigned for the partner, and this in itself would be such a change as would dissolve the partnership. Hence, a partnership is dissolved by operation of law by such an assignment, no matter with what intentions it may have been made.

121. **Same subject—Illegal business.**—The law will recognize only a legal business as the basis of a partnership. But a business may be legal at one time and illegal at another. If this happens the partnership will be recognized so long as its business was legal, but will receive no recognition after the business has become illegal. Suppose that A, a citizen of Great Britain, is in partnership with B, a citizen of the United States. The partnership is entirely

[5] Eustis v. Bolles, 146 Mass. 413, 16 N. E. 286.

ship to be dissolved by the arbitrary action of any one of the partners. They hold that "Even when partners covenant with each other that the partnership shall continue seven years, either partner may dissolve it the next day by proclaiming his determination for that purpose; the only consequence being that he thereby subjects himself to a claim for damages for a breach of his covenant."[9]

125. **Dissolution by judgment.**—In such jurisdictions which hold that any partnership may be dissolved by arbitrary action of any one of the partners, there can be no occasion to resort to the courts to obtain a dissolution. Where, however, it is held that partnerships for a fixed time or for the accomplishment of a certain object cannot be dissolved by the act of less than all the partners, a resort to the courts may become necessary. Certain intolerable situations arise which defeat the very object of the partnership. One of the partners may become insane or totally incapable, for other reasons, of performing the duties which he has assumed. The business of the partnership may prove to be unprofitable. Some one of the partners may be found guilty of gross misconduct, great extravagance, unwarrantable negligence, misappropriation of funds and the like. When such circumstances arise the object of the partnership is defeated. A situation has arisen very much like the situation which arises in marriages and which calls for a divorce. Upon just cause appearing such partnerships will be dissolved by the courts.

[9] Solomon v. Kirkwood, 55 Mich. 256, LEADING ILLUSTRATIVE CASES.

CHAPTER XI.

MISCELLANEOUS—CLASSIFICATION OF PARTNERSHIPS AND PARTNERS.

126. **Abnormal partnerships.**—A partnership in the ordinary sense of the word involves, among other conceptions, an unlimited liability of each partner for all the debts created in the conduct of the partnership's business, and a close, confidential relation between all the partners. Both these conceptions have proved inconvenient as applied to certain situations; hence, abnormal partnerships have been developed which have dispensed with one or the other of them. The unlimited liability of a partner has been restricted by statutes allowing the formation of limited partnerships. Furthermore, there is a species of partnership where the close personal trust and confidence are not required. These are known as joint stock companies and mining partnerships.

127. **Definition of limited partnership.**—A limited partnership is a partnership consisting of one or more general partners who conduct the business and are responsible for its debts, without limit, and one or more special partners who take no active part in the business, but merely contribute a specific sum of money to it and are not personally liable for its debts. These partnerships are permitted to exist in order to encourage trade, "by authorizing and permitting a capitalist to put his money into a partner-

ship with general partners possessed of skill and business character only without becoming a general partner or hazarding anything in the business except the capital originally subscribed."[10] They enable men, "under certain reasonable conditions," to do business with a restricted liability, who, without such restrictions, would suffer a portion of their capital to remain unemployed rather than risk their whole possession under the broad liability of a general partnership."[11] They originated in France during the middle ages and arose out of the necessity of finding some method by which the nobles and clergy could use their accumulated wealth in trade without taking an active part in business, or subjecting themselves to any liability beyond their original investment. In England and America they rest on statutory provisions which vary more or less in the different states.

128. **Creation of limited partnership.**—As has been seen, a general partnership may be created by mere agreement of the parties without any formalities, and for any legitimate purpose. A different rule applies to limited partnerships. The statutes generally confine these partnerships to mercantile, manufacturing and mechanical ventures, and prescribe various formalities that must be substantially, or, as some cases hold, strictly, followed before a limited partnership comes into existence. These formalities are not uniform throughout the various states. Generally, however, the statutes require that

[10] Singer v. Kelly, 44 Penn. 145, 149.

[11] Manhattan Co. v. Laimbeer, 108 N. Y. 578, 582, 15 N. E. 712.

a certificate duly acknowledged and stating the name, the duration of the proposed partnership, its place of business, the names of the various partners and the amount of capital which each special partner has contributed, be published in a newspaper or otherwise, and be filed and recorded in a certain office, with proof of such publication. Most states, in addition, also require that an affidavit of one or more of the general partners be filed stating that the sums specified in the certificate have been actually paid by the special partners. If these formalities are not complied with, or if the money to be contributed by the special partners is not actually paid, the partnership will be considered as a general partnership, and each partner will be held liable for all the debts of the business.

129. **Termination of special partnership.**—A special partnership will, as a general rule, go out of existence in exactly the same way as a general partnership. It will be dissolved by operation of law by the death of any one of the partners, general or special. It will be dissolved by the courts whenever it has become apparent that the purposes of the partnership cannot be realized. It may also die a natural death by the expiration of its own time limit. Every alteration made in the names of the general partners or in any matter which is an essential part of the original certificate, will work a dissolution of the firm. If the business is continued notwithstanding the expiration of its own time limit or the change, the partnership will be treated as a general partnership and the special partner will be held liable for

all the debts of the business. The dissolution of a special partnership by agreement of the parties, however, is not such an easy matter as the dissolution of a general partnership. The statutes generally require that in such a case a notice of dissolution must be published in substantially the same manner as the original certificate was published before such dissolution will become effectual.

130. **Duties and liabilities of special partners.**—The duties and liabilities of the general partner in a limited partnership do not differ in the least from the duties of such a partner in a general partnership. Every general partner is liable for all the debts of the firm and is in duty bound to pay them or see that they are paid. The special partner, on the other hand, is very much in the same position as a stockholder in an ordinary corporation. He takes no direct share in the management of the business, and is not responsible personally for any of its debts. The money or property which he has contributed has passed from his control very much like the money contributed by a subscriber to stock in a corporation passes from the control of such subscriber. Thereafter whatever liability there is will attach to the money furnished by the special partner and will not be a personal obligation against him.

131. **Joint stock companies.**—Joint stock companies are partnerships with a capital stock divided into shares which may be freely assigned by the owners to anyone, like shares in a corporation. Joint stock companies originated in England at the time when navigation and colonization began to occupy the

minds of the people. Large companies such as the East Indies Company, were chartered by the crown and given the powers and privileges of corporations. "But there were large societies on which the sun of royalty and legislative favor did not shine, and as to whom the whole desire of the associates and the whole aim of the ablest legal assistants they could obtain, were to make them as nearly a corporation as possible with continuous existence, with transmissible and transferable stock, but without any individual right in any associate to bind the other associates or to deal with the assets of the association." The result of this was the creation of joint stock companies.[12]

These companies, like corporations, are formed for the aggregation of capital, rather than for the union of personal talents. Like corporations, they are managed by a board of directors and not by the individual members. Their members are so numerous that they cannot and do not know each other. Hence it becomes quite immaterial to one member who his co-members are. He places no reliance on them. He is interested only in the money which they contribute. It follows that the shares in such a company may be freely assigned and that the company will not be dissolved by the death or bankruptcy of any of its members.

132. **Mining partnership.**—A mining partnership is an association of the several owners of a mine for coöperation in working it. It is in fact a cross between a common ownership and a partnership

[12] In re Agriculturist Cattle Insurance Co., 3 De G. J. & S. 425 (Eng.).

proper.[13] "Associations in working mines are generally composed of a greater number of persons than ordinary partnerships; and it was early seen that the continuous working of a mine, which is essential to its successful development, would be impossible, or at least attended with great difficulty if an association was to dissolve by the death or bankruptcy of one of its members, or the assignment of his interest. A different rule from that which governs the relations of members of a trading partnership to each other was therefore recognized as applicable to the relations to each other of members of a mining association."[14] Adapting themselves to conditions, courts have universally held that no personal confidential relation is involved in these associations and that hence the death of any member of the association does not dissolve it. Of course where the parties so intend, they may form a partnership for working a mine which will depend upon mutual confidence and which will be dissolved by the death or bankruptcy of a partner. However, to reach this result, they must make a special agreement to this effect.[15]

133. **Kinds of partners.**—As there are various kinds of partnerships so there are various kinds of partners. The following is a classification of them:

General and special partners. A general partner being one whose liability for partnership debts is unlimited, the term has no significance as applied to members of ordinary partnerships, who are neces-

[13] Nolan v. Lovelock, 1 Mont. 224.
[14] Kahn v. Smelting Co., 102 U. S. 641, 645.
[15] Hartney v. Gosling, 10 Wyo. 346, 68 Pac. 1118.

sarily all general partners. It is used merely to distinguish the one or more members of a limited partnership who are not special partners; that is, whose liability is not limited to a defined amount, as is that of the special partners.

Ostensible partners. An ostensible partner is one whose connection with the firm is openly avowed, either by means of the firm sign or otherwise.

Secret partners. A secret partner, on the other hand, is one whose connection with the firm is concealed, or at least is not announced or made known to the public.

Silent partners. A silent partner, while having his right to a share of the firm profits, nevertheless has no voice in the management of the partnership business. This restriction, which is placed upon his power by the mutual agreement of the partners, will not, however, be allowed to work to the detriment of a third person, who deems himself, upon good grounds of belief, in dealing with a partner, to be dealing with the firm.

Dormant partners. A dormant partner combines in himself the characteristics of both the secret and the silent partner. Although his identity may be a secret, and he may not transact any of the business of the firm, he still maintains the relation of principal to his agent, the fellow partner. Once the secret of his existence is disclosed, the dormant partner, like the undisclosed principal in the law of agency, is held to strict partnership liability, even where he has attempted to disguise himself as a mere lender.[16]

[16] Gilmore, Partnership, pp. 110-112.

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LAW OF BANKS, BANKING AND TRUST COMPANIES

BY

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1. **Introductory.**—From the beginning of commerce there has been co-existing mechanism of exchange, whereby commercial transactions could be concluded by the convenient transfer of money or its equivalent in payment for merchandise or labor. In the New Testament era the money changer conducted his business in the temple (Mark xi, 15), and for a long time what crude banking there was, was conducted in public places, the coins involved being handled upon a table or bench, called *banche,* from which its user acquired the appellation of banker. When the banker failed, his *banche* was broken and destroyed (Italian, *banca rota*), whence comes our word bankrupt. The body of law which has grown out of and around the subject of banking must be read with a view to the banker's place as a factor in social economy, as a trustee of the counters used by others who do the world's real work, whether that work be war, manufacture, barter and sale, or labor.

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2. **Definitions.**—*Bank.* A bank is a depository for money,[1] "as that is the most obvious purpose of such an institution."[2]

Banking. The modern definition of banking, as formulated by the United States Supreme Court, is as follows: "The business of banking, as defined by law and custom, consists in the issue of notes payable on demand, intended to circulate as money, where the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper; making loans of money on collateral; buying and selling bills of exchange; negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations."[3] The privileges of banking, except as to the privilege of issuing bank bills or other indicia to circulate as money, never belonged to sovereignty at common law; the business of banking was open to all.[4]

"Money may not be equally distributed. It is a bank's function to correct the inequality. The very object of banking is to aid the operation of the laws of commerce by serving as a channel for conveying money from place to place, as the rise and fall of supply and demand require."[5]

The right to engage in the business of banking is

[1] Bouvier, Dictionary, (Rawle's Rev.), title "Bank."

[2] Mr. Justice Clifford, in Oulton v. Savings Inst., 17 Wall. 109 (U. S.), 21 L. Ed. 618.

[3] Matthews, J., in Mercantile Bank v. New York, 121 U. S. 138, 30 L. Ed. 895.

[4] State v. Scougal, 3 S. Dak. 55, 51 N. W. 858, 15 L. R. A. 477.

[5] Mr. Justice McKenna, in Auten v. United States Natl. Bank, 174 U. S. 125, 143, 43 L. Ed. 920.

peculiarly within the police power of the states, which may, therefore, take the whole business of banking under their control. The state, it is said, "may go on from regulation to prohibition except upon such terms as it may prescribe."[6]

Trust companies. Trust companies, so called, are invariably the creature of general or special statute. They did not exist at common law, but are the statutory creatures which exercise the functions, or some of the functions, of trustees. Hence it is difficult to formulate any definition of general value. Perhaps the following definition is as good in general application as any judicial definition to be found in the reports: "A trust company accepts and executes all trusts of every description committed to it by any person or corporation, or any courts of record; receives the title to real or personal estate on trusts created in accordance with the laws of the state, and executes such trusts; acts as agent for corporations in reference to the issuing, registering, and transferring certificates of stock and bonds and other evidences of debt; accepts and executes trusts for married women in respect to their separate property, and acts as guardian for the estates of infants. It is very obvious that trust companies are not, in the legal or commercial sense, engaged in the business of banking."[7] This last sentence has been confirmed by the United States Supreme Court: "Trust companies are not banks in the commercial sense of that word, and do

[6] Mr. Justice Holmes in Noble State Bank v. Haskell, 219 U. S. 113, 55 L. Ed. 117.

[7] Bartlett, J., in Jenkins v. Neff, 163 N. Y. 320, 57 N. E. 408, affirmed in Jenkins v. Neff, 186 U. S. 230, 46 L. Ed. 1140.

not perform the functions of banks in carrying on the exchanges of commerce."[8]

National banks, as distinguished from state banks and trust companies. By reason of federal legislation, national banks occupy a position which in several respects contrasts with those of state banks or trust companies.

"A national bank is authorized to issue notes payable on demand, intended to circulate as money, and while compelled to secure its circulation by the deposit of United States securities, it can employ the balance of its capital for business purposes, thereby securing a profitable return for its stockholders. A national bank occupies a distinct field of operation as compared with a trust company, and enjoys privileges that are not accorded to the latter, which are a source of great profit. * * * The federal government imposes a tax of 10 per cent. on the bills issued by state banks, which practically prevents them from competing with national banks in putting out circulation, which is greatly to the advantage of the latter."[9]

Savings banks. "They are what their name indicates—banks of deposit for the accumulation of small savings belonging to the industrious and thrifty. To promote their growth and progress is the obvious interest and policy of the state."[10] They differ from ordinary commercial banks in that their deposits are

[8] Mr. Justice Matthews, in Mercantile Natl. Bank v. New York, 121 U. S. 138, 30 L. Ed. 895.

[9] Bartlett, J., in Jenkins v. Neff, 163 N. Y. 320, 57 N. E. 408.

[10] Mr. Justice Matthews, in Mercantile Natl. Bank v. New York, 121 U. S. 138, 30 L. Ed. 895.

not generally subject to check.[11] In Massachusetts and some other jurisdictions they have neither capital stock nor shareholders,[12] but the fact that a bank has a fixed capital stock and stockholders is not conclusive in determining whether or not it is a savings bank.[13] They are usually merely banks of deposit, without authority to make discounts or issue a circulating medium.[14] They may be created in various ways, and the term "savings bank" is extended, by express statute, in Connecticut, to include societies for savings, and saving societies.[15]

Private banks. Much of the volume of banking business is conducted by partnerships or individuals, and these, as distinguished from incorporated banks (state or national), are designated as "private" banks. The investigation of the Pujo Congressional Committee in 1913 drew attention to the power and abuse of these institutions. They have been at all times the subject of legislative consideration, and are peculiarly within legislative control. State legislation may abolish such banks altogether,[16] or may exact a license fee, and leave the granting of the license to a state officer.[17]

Clearing house. The clearing house is an important factor in the banking of all commercial centers. It has been defined as "an ingenious device to simplify and facilitate the work of the banks in reaching

[11] National Bank v. Boston, 125 U. S. 60, 31 L. Ed. 689.
[12] Commonwealth v. Reading Sav. Bank, 133 Mass. 16.
[13] State v. Lincoln Sav. Bank, 82 Tenn. (14 Lea) 42.
[14] Bank for Savings v. Collector, 3 Wall. 513 (U. S.), 18 L. Ed. 207.
[15] Gen. Stats. Conn., 1902, § 1.
[16] Noble State Bank v. Haskell, 219 U. S. 113, 55 L. Ed. 117.
[17] Engel v. O'Malley, 219 U. S. 137, 55 L. Ed. 136.

an adjustment and payment of the daily balances due to and from each other, at one time and place. * * * It is a place where the representatives of all the banks in the city meet, and, under the supervision of a competent committee or officer selected by the associated banks, settle their accounts with each other, and make and receive payment of balances, and so 'clear' the transactions of the day for which the settlement is made."[18] It is not to be regarded as a mutual bank, organized and operated by the associated banks.[19] In some cases notes as well as checks are cleared for collection.[20] The clearing-house system is said to have originated in Edinborough; that of London was founded in 1775 or earlier. The New York clearing house was established in 1853, that of Boston in 1856, those of Cleveland, Baltimore, and Philadelphia in 1858, that of Worcester in 1861, and Chicago in 1865.[21]

Banks and bankers, as defined by federal statute. For the purposes of the internal revenue, Congress has defined the words "bank" and "banker," in the United States Revised Statutes, § 3407, as follows: "Every incorporated or other bank, and every person, firm, or company having a place of business where credits are opened by the deposit or collection of money or currency, subject to be paid or remitted upon draft, check, or order, or where money is advanced or loaned on stocks, bonds, bullion, bills of

[18] Williams, J., in Crane v. Fourth St. Natl. Bank, 173 Pa. 566, 34 Atl. 296.

[19] Same case as in note 18.

[20] Exchange Bank v. Bank of North America, 132 Mass. 147, 150.

[21] Crane v. Clearing-House, 32 W. N. C. 358 (Pa.).

exchange, or promissory notes, or where stocks, bonds, bullion, bills of exchange, or promissory notes are received for discount or for sale, shall be regarded as a bank or as a banker."

Under this section there are three classes of bankers: those who have a place of business where credits are opened by the deposit or collection of money or currency, subject to be paid or remitted upon draft, check, or order; those who have a place of business where money is advanced or loaned on stocks, etc.; those who have a place of business where stocks, etc., are received for discount or for sale.[22] A loan and trust company issuing deposit certificates and receiving money in trust under special contracts has been held to be a banker within the meaning of this statute.[23]

3. **Banking corporations generally.**—Banking corporations differ from other corporations only in the scope of their corporate powers. The enabling act under which the incorporation is effected, and the charter, are to be examined and construed for the determination of the extent of the corporate powers, just as in the case of other corporations. The question of their legislative control has received much consideration from the courts in the past, but has been definitely settled by the Supreme Court of the United States. The state may compel incorporation as a condition to engaging in banking, may take the whole business of banking under its control, and require inspection, or even coöperation among all the

[22] Selden v. Equitable Trust Co., 94 U. S. 419, 24 L. Ed. 249.
[23] United States v. Farmers' L. & T. Co., Fed. Case 15,070.

banks of the state, to protect depositors.[24] National banks are purely the creature of congressional legislation and must be separately considered. But the state and national banking systems are intimately related from a legal standpoint, in that state banks may be converted into national banks without abandoning their corporate identity and existence; the national charter is treated as a continuation of the state charter,[25] and the new national bank takes the assets and assumes the liabilities of the former corporation.[26]

4. **Banking corporations—The charter.**—Banks may be organized under a general corporation law, in which case the charter comprises its certificate issued, and articles filed under the law, and the text of the law itself.[27] Or the bank may be created by a special legislative enactment, in which case the act itself constitutes the charter.[28] In either case, the by-laws of the corporation are not a part of its charter, and they cannot limit or enlarge the corporate powers.[29]

5. **National banks.**—National banks are federal corporations. The power of Congress to incorporate national banks was early recognized.[30]

The National Bank Act, in its more important particulars, provides as follows (references being to the sections of the Revised Statutes of the United

[24] Noble State Bank v. Haskell, 219 U. S. 113, 55 L. Ed. 117.
[25] City Natl. Bank of Poughkeepsie v. Phelps, 97 N. Y. 44.
[26] Michigan Ins. Bank v. Eldred, 143 U. S. 293, 36 L. Ed. 162.
[27] People v. Chicago Gas Trust Co., 130 Ill. 268.
[28] Mechanics' & Traders' Bank v. Rowly, 2 La. Ann. 372.
[29] Brewster v. Hartley, 37 Cal. 15.
[30] McCulloch v. Maryland, 4 Wheat. 316 (U. S.), 4 L. Ed. 579.

States): § 5138 provides that in any place whose population does not exceed three thousand inhabitants, a national bank may be established with a capital of not less than $25,000; where the population does not exceed six thousand, the bank's capital shall not be less than $50,000; while in a city whose population exceeds 50,000, the capital shall be not less than $200,000. Under § 5133, any number of natural persons, not less than five, may form an association by signing articles specifying the object, a copy of which shall be filed with the Comptroller of the Currency and preserved in his office. § 5134 provides the requirements of an organization certificate, which § 5135 requires shall be recorded and preserved by the Comptroller of the Currency. § 5136 defines the corporate power of national banks as follows:

First. To adopt and use a corporate seal.

Second. To have succession for the period of twenty years from its organization, unless it is sooner dissolved according to the provisions of its articles of association, or by the act of its shareholders owning two-thirds of its stock, or unless its franchise becomes forfeited by some violation of law.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law and equity, as fully as natural persons.

Fifth. To elect or appoint directors, and by its board of directors to appoint a president, vice-president, cashier, and other officers, define their duties, require bonds of them, and fix the penalty thereof,

dismiss such officers or any of them at pleasure, and appoint others to fill their places.

Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To exercise, by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this Title.

The same section provides that such associations shall only transact the business incidental and necessary to organization, before such time as the Comptroller of the Currency authorizes the commencement of the business of banking.

By § 5140, 50 per cent. of the capital stock must be paid before the association is authorized to commence business, and the remainder must be paid in installments of at least 10 per cent. on the whole amount of the capital as frequently as one installment per month, each payment being certified to the Comptroller of the Currency; § 5141 provides the procedure if the shareholder fails to pay any installment.

By § 5151 it is provided that the shareholders shall be held individually responsible for all contracts, debts, and engagements of the association to the extent of the amount of their stock at the par value, in addition to the amount invested.

§ 5152 provides that persons holding stock as executors, administrators, guardians, or trustees shall not be personally subject to any liabilities as stockholders, the liability falling upon the estates and funds in their hands.

§ 5153 provides that the Secretary of the Treasury may designate national banks as depositaries of public money.

§ 5154 provides for the conversion of state into national banks.

§ 5159 provides that every association, before being authorized to commence banking business, shall transfer and deliver to the Treasurer of the United States registered bonds of the United States, bearing interest, to an amount not less than $30,000, and that not less than one-third of the capital stock shall be paid in; that deposit must be increased as the capital stock is paid up or increased so that there shall be on deposit at all times such bonds to the amount of at least one-third of the capital stock which is actually paid in.

By § 12 of the Act of March 14, 1900, Chapter 41, 31 Statutes at Large 49, it is provided that upon the deposit of bonds being made, the association shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, equal in amount to the par value of the deposited bonds, of the denomi-

nations prescribed by law, which notes, being signed by the proper officers of the bank, are made legal tender at par, by § 5182, in payment of taxes, excises, public lands, and all other dues to the United States except duties on imports, and for all salaries, debts, and demands owing by the United States, except interest on the public debt, and in redemption of the national currency.

Notes payable in gold may be issued by such associations, under § 5185, provided that United States gold bonds have been deposited with the Comptroller of the Currency.

§ 5219 provides that the shares of stock may be taxed as the personal property of their owners or their holders, the shares owned by non-residents being taxable in the city or town where the bank is located. Real property owned by the association is subject to the same state, county, and municipal taxes as other real property.

§ 5243 provides a penalty of $50 per day for the use of the word "National" as part of the name of any bank not organized under the National Bank Act.

In regard to national banks, the federal courts have clearly interpreted those powers which the National Bank Act left open to argument. Such banks, therefore, may—

(a) Receive special deposits, including United States bonds.[31]

(b) Certify checks.[32]

[31] First Natl. Bank v. Graham, 100 U. S. 699, 25 L. Ed. 750.

[32] Merchants' Bank v. State Bank, 10 Wall. 604 (U. S.), 19 L. Ed. 1008.

(c) Guarantee promissory notes sold by it.[33]

(d) Retain possession of bonds by purchase made by the national bank under an ultra vires contract; but such retention is only as security for the return of the consideration paid by it.[34]

(e) Borrow money and give notes temporarily, though not expressly authorized by the Act, under exceptional circumstances.[35]

(f) Lend money and discount notes.[36]

All of these powers are expressly or impliedly delegated by § 5136, Revised Statutes of the United States.

National banks have no power—

(a) To act as stock and bond broker.[37]

(b) To make any loan or discount on the security of their own capital stock.[38]

(c) To subscribe for capital stock in a speculative enterprise.[39]

(d) To hold stock of a savings bank not taken as security or otherwise acquired in the regular course of banking business.[40]

(e) To invest its funds in shares of stock in another national bank.[41]

(f) To take as absolute owner, in satisfaction of a debt, an interest in a partnership.[42]

[33] People's Bank v. Manufacturer's Natl. Bank, 101 U. S. 181, 25 L. Ed. 907.
[34] Logan County Natl. Bank v. Townsend, 139 U. S. 67, 35 L. Ed. 107.
[35] Western Natl. Bank v. Armstrong, 152 U. S. 346, 38 L. Ed. 470.
[36] First Natl. Bank v. National Exch. Bank, 92 U. S. 122, 23 L. Ed. 679.
[37] Same.
[38] First Natl. Bank v. Lanier, 11 Wall. 369 (U. S.), 20 L. Ed. 172.
[39] First Natl. Bank v. Converse, 200 U. S. 425, 50 L. Ed. 537.
[40] California Natl. Bank v. Kennedy, 167 U. S. 362, 42 L. Ed. 198.
[41] First Natl. Bank v. Hawkins, 174 U. S. 364, 43 L. Ed. 1007.
[42] Merchants' Natl. Bank v. Wehrmann, 202 U. S. 295, 50 L. Ed. 1036.

(g) To purchase a note secured by a deed of trust on real estate; but only the government can complain of the transaction;[43] and it may sell its real estate and take a mortgage for the unpaid purchase price,[44] and it may take a chattel mortgage as security for a preëxisting debt.[45]

(h) To take a mortgage as security for future advances to be made the mortgagor; but of this only the government can complain.[46]

6. **Liability of banks for torts.**—As to unincorporated banks, the persons or firms so doing business are, of course, liable for their wrongs not arising out of contract, just as other individuals; subject to such special rules as to damage as are involved in transactions peculiar to banking, such as the liability for damage for the dishonor of checks, which we will hereafter consider.

As to the liability of banking corporations for torts, the general rule applies, that "corporations are liable for every wrong they commit, and in such cases the doctrine of ultra vires (beyond the power) has no application. * * * An action may be maintained against a corporation for its malicious or negligent torts, however foreign they may be to the object of its creation or beyond its granted powers."[47] This was said by Mr. Justice Swayne in an action at law against the receiver of a national bank to recover the value of bonds stolen from the vaults of the bank,

[43] Swope v. Leffingwell, 105 U. S. 3, 26 L. Ed. 939.
[44] New Orleans Natl. Bank v. Raymond, 29 La. Ann. 355.
[45] Spafford v. First Natl. Bank, 37 Iowa 181.
[46] Fortier v. New Orleans Natl. Bank, 112 U. S. 439, 28 L. Ed. 764.
[47] National Bank v. Graham, 100 U. S. 699, 25 L. Ed. 750.

and in that case a judgment for the plaintiff was affirmed. So we find a national bank held liable for false imprisonment,[48] a savings bank for malicious prosecution;[49] while a bank has been held liable for money lost on a fake racing contest, its officers vouching for the integrity of the principal swindler.[50] Other cases in which the liability of banks for tort has been asserted are, for conspiracy with a merchant to defraud vendors selling goods to the merchant.[51] In this line of cases, it is important to note that it is more difficult to establish fraud against a corporation than against an individual; as to this, some of the leading cases make the difference in proof, and its reasons, quite clear.[52]

7. **Deposits.**—Bank deposits are of two classes: those in which the bank becomes bailee of the depositor, the title of the thing deposited remaining in the depositor, which are called special deposits; and those in which the depositor parts with the title to the specific money deposited, and the bank agrees to repay the amount, or any part thereof, on demand. The latter class are known as general deposits, and are subject to check.[53] In the absence of contract to the contrary, a deposit is presumed to be general,[54]

[48] Wachsmuth v. Merchants' Natl. Bank, 96 Mich. 426, 56 N. W. 9.

[49] Reed v. Home Savings Bank, 130 Mass. 443.

[50] Stewart v. Wright, 147 Fed. 321, 77 C. C. A. 499. A very doubtful case; see Judge Sanborn's dissent.

[51] Johnston Fife Hat Co. v. National Bank, 4 Okl. 17, 44 Pac. 192.

[52] Craigie v. Hadley, 99 N. Y. 131, 1 N. E. 537; Foster v. Essex Bank, 17 Mass. 479, 509; the view of Judge Cooley (Cooley on Torts, p. 119) is adopted and applied in Western News Co. v. Wilmarth, 33 Kan. 510, 6 Pac. 786.

[53] Marine Bank v. Fulton Bank, 2 Wall. 252 (U. S.), 17 L. Ed. 787.

[54] Bank of Kentucky v. Wister, 2 Peters 318 (U. S.), 7 L. Ed. 123.

and in the absence of contract to pay interest, a bank is not liable for interest on deposits.[55] Banks do not assume liability for transmission to depositors through the mail. Funds which are subject to check are payable at the bank, and when they are remitted by mail on the request of the depositor it is at his risk.[56]

8. **Checks.**—Checks are part of the distinctive equipment of banking. They differ from other commercial paper in many important particulars. Possibly the best definition is: "a check is a draft or order upon a bank or banking house, purporting to be drawn upon a deposit of funds, for the payment at all events of a certain sum of money to a certain person therein named, or to him, or his order, or to bearer, and payable instantly on demand."[57] Checks have frequently been compared with bills of exchange;[58] in some states they are by statute classed as bills of exchange, payable upon demand.[59] As to form, checks must be signed to correspond with the name of the account as established with the bank. Thus, on a deposit as trustee, the individual check of the trustee will not be honored,[60] and a partnership account cannot be drawn upon by the individual check of a member of the firm.[61] The two chief char-

[55] Parkersburg Natl. Bank v. Als, 5 W. Va. 50.

[56] Jung v. Second Ward Sav. Bank, 55 Wis. 364, 13 N. W. 235.

[57] Daniel, Negotiable Instruments (4th ed.), § 1566; adopted in U. S. v. Green, 136 Fed. 618, 645.

[58] Lewis, Hubbard & Co. v. Montgomery Supply Co., 59 W. Va. 75, 52 S. E. 1017.

[59] Amsinck v. Rogers, 93 N. Y. Supp. 87; affirmed, 189 N. Y. 252, 82 N. E. 134.

[60] Ihl v. St. Joseph Bank, 26 Mo. App. 129.

[61] Coote v. U. S. Bank, 3 Cranch 50 (U. S.), Fed. Case 3203.

acteristics of checks are, that they are drawn upon a bank, and are payable instantly, on demand.[62]

9. **Checks—Form of.**—In the absence of statute, the necessary contents of a check are few in number:

1. The drawee must be named. It must be drawn on a bank or banker.[63]

2. As to its date of issuance, there is no positive requirement that it be dated at all; if post-dated, it is not payable before its date.[64]

3. A payee must be named; an omission in this regard is fatal to the validity of the check.[65]

4. The drawer's signature must be affixed; it must correspond with the signature entered on the books of the bank.[66]

5. The amount must be stated,—usually is written in words in the body of the check and in figures on the margin. In case of variance between such words and figures, the words control, and the figures are disregarded,[67] the figures being treated as a non-essential part of the check.[68]

10. **Checks—Presentment.**—Before presentation to the drawee, and notice of dishonor, no action lies against either drawer or endorsers upon the check.[69] The presentment must also be made within a reasonable time.[70] What is a reasonable time depends upon

[62] Bowen v. Needles Natl. Bank, 87 Fed. 438.
[63] Bull v. Bank of Kasson, 123 U. S. 105, 31 L. Ed. 97.
[64] In re Brown, 2 Story 502 (U. S.), Fed. Cas. 1985.
[65] McIntosh v. Lytle, 26 Minn. 336, 3 N. W. 983.
[66] Ihl v. St. Joseph Bank, 26 Mo. App. 129.
[67] Smith v. Smith, 1 R. I. 398.
[68] National Bank v. Lafayette Bank, 69 Ind. 479.
[69] Morrison v. McCartney, 30 Mo. 183.
[70] Walsh v. Dart, 23 Wis. 334.

all of the circumstances of the case, and its reasonableness, when the facts are undisputed, is a question of law for the court.[71] Speaking generally, it is the duty of each successive holder of the check to transfer it by endorsement, or start its transmission to the drawee by the next day after the day of its receipt. If the original payee is in the same locality as the drawee bank, he should either negotiate it or present it by the following day after its delivery to him.[72] If he is in another locality, he should negotiate it or forward it for presentment within the same length of time.[73] But the drawer of a check is not discharged from liability upon it because of laches in its presentation unless he can show that he has sustained some injury because of the delay.[74] As to the endorsers, however, they are discharged from liability altogether if presentment has been delayed an unreasonable time.[75]

Presentment is unnecessary, and consequently notice is unnecessary, where the drawer has stopped payment by notice to the bank,[76] where the drawer has no funds in the bank, and no reason to expect to have any,[77] or where the bank is prevented by injunction from making payments.[78]

11. **Checks—Dishonor.**—An action for damages for the dishonor of a check sounds in contract. "The

[71] Rosenthal v. Ehrlicher, 154 Pa. St. 396, 26 Atl. 435.
[72] Veazie Bank v. Winn, 40 Me. 62.
[73] Haggerty v. Baldwin, 131 Mich. 187, 91 N. W. 150.
[74] Bull v. Bank of Kasson, 123 U. S. 105, 31 L. Ed. 97.
[75] Kirkpatrick v. Puryear, 93 Tenn. 409, 24 S. W. 1130.
[76] Purchase v. Mattison, 25 N. Y. 211.
[77] Case v. Morris, 31 Pa. St. 100.
[78] Lovett v. Cornwell, 6 Wend. 369 (N. Y.).

relation between banker and depositor is one by contract. The right of the latter is that, to the extent of his credit balance subject thereto, his checks drawn and presented according to the customs and usages of the business shall be promptly honored. For a breach of this right an action for damages will lie. If the depositor is a merchant or trader, it will be presumed, without further proof, that substantial damages have been sustained."[79] But unless the depositor is a merchant or trader, there is no such presumption of substantial injury, and special damage must be pleaded or proven, or his recovery will be limited to nominal damages; as to this, the authorities apparently differ.[80] So the liability of the bank to the drawer of a dishonored check is clear, though the measure of damages is not. But as to the liability of the bank to the holder of the check, for dishonor when the drawer's deposit is adequate to meet it, there is a keen conflict in the decisions. The United States Supreme Court has squarely held that the payee of an unaccepted check cannot maintain an action against the bank on which the check is drawn,[81] and this is the rule of most of the state courts.[82] Its reason is that there is no relationship of privity between the bank and the payee.[83] In other jurisdictions, the liability of the bank is asserted upon the

[79] Hook, J., in Third Natl. Bank v. Ober, 178 Fed. 678.

[80] Same case as in note 79.

[81] Bank of the Republic v. Millard, 10 Wall. 152 (U. S.), 19 L. Ed. 897; First Natl. Bank v. Whitman, 94 U. S. 343, 24 L. Ed. 229; Fourth Str. Bank v. Yardley, 165 U. S. 634, 41 L. Ed. 855.

[82] Carr v. National Security Bank, 107 Mass. 45; Seventh Nat. Bank v. Cook, 73 Pa. 483.

[83] First Natl. Bank v. Whitman, 94 U. S. 343, 24 L. Ed. 229.

theory of an implied promise by the bank to the checkholder.[84]

12. **Checks—Certification.**—The certification of a check by the bank upon which it is drawn is a warranty that the drawer has sufficient funds, and that the amount has been charged against the drawer and placed to the credit of the check.[85] Certification renders the bank primarily liable for payment to any bona fide holder of the check.[86] In Illinois it has been held, however, that the bank does not, by certification, warrant the genuineness of the body of the check.[87] In some states, by statute, certification is required to be in writing.[88] There may be a technical distinction between checks certified and checks accepted; but the effect on the banker is the same, and if a bank accepts by telegraph, it is liable, in the absence of statute to the contrary, precisely as on a certified check.[89] Certification does not extend to the indorsements,[90] however, and while it does guarantee the drawer's signature,[91] so that it cannot rely on forgery thereof as a defense against a bona fide holder,[92] it does not guarantee the genuineness of the body of the check, and if free from negligence, the bank can recover moneys paid by it upon a raised

[84] Roberts v. Austin, Corbin & Co., 26 Iowa 315; National Bank of America v. Indiana Banking Co., 114 Ill. 483, 2 N. E. 401.

[85] Central Guarantee, etc., Co. v. White, 206 Pa. 611, 56 Atl. 76.

[86] Poess v. Twelfth Ward Bank, 86 N. Y. Supp. 857.

[87] Continental Natl. Bank v. Metropolitan Natl. Bank, 107 Ill. App. 455.

[88] Risley v. Phenix Bank, 83 N. Y. 318; affirmed, 111 U. S. 125, 28 L. Ed. 374.

[89] North Atchison Bank v. Garretson, 51 Fed. 168, 2 C. C. A. 145.

[90] Williams v. Drexel, 14 Md. 566.

[91] Clews v. Banking Assn., 89 N. Y. 418.

[92] Commercial Bank v. Natl. Bank, 30 Md. 11.

check, though it was certified before payment, the recovery being as for money paid by mistake.[93]

The effect of certification as between drawer and payee is, that if the drawer has the check certified before delivery to the payee, the drawer is not discharged,[94] while if it is certified on the presentation by the holder or payee, that fact discharges the drawer.[95]

Certification or acceptance may be evidenced by the bank writing upon the check the word "good," or any similar words which indicate a statement by the bank that the drawer has funds in its hands applicable to the payment of the check, and that it will so apply them.[96]

13. **Checks—"Stop payment" instructions.**— "The giving of the check is not the creation of an obligation, but the admission of the existence of an obligation to pay a certain sum of money."[97] A check does not constitute an equitable assignment of the fund on which it is drawn,[98] so that the holder of a check is not entitled to priority over general creditors in a fund in the hands of an assignee for the benefit of creditors.[99] In view of these characteristics of the check, its payment can be stopped by the drawer at any time before it is paid,[1] and by so doing he relieves the payee of any obligation to present the check or

[93] Clews v. Banking Assn., 89 N. Y. 418.
[94] Minot v. Russ, 156 Mass. 458, 31 N. E. 489.
[95] First Natl. Bank v. Currie, 147 Mich. 72, 110 N. W. 499.
[96] First Natl. Bank v. Whitman, 94 U. S. 343, 24 L. Ed. 229.
[97] Ray, J., in United States v. Green, 136 Fed. 618, 645.
[98] Same case as in note 97.
[99] Fourth Str. Bank v. Yardley, 165 U. S. 634, 41 L. Ed. 855.
[1] United States v. Green, 136 Fed. 618, 645.

give notice of its non-payment.[2] In this regard, certification by the bank is the equivalent of payment of the check; the drawer cannot stop payment after certification,[3] and if the bank certified a check after a "stop payment" order from the drawer, he can hold the bank liable for the amount.[4] In Wisconsin, however, the general rule of the absolute right of the drawer to stop payment is not followed, and it is held that he can only stop payment for good and sufficient cause.[5] But the general rule is that his right to stop payment is unqualified, and is unaffected by the transfer of the check by the original payee to an innocent holder for value;[6] in the language of the United States Supreme Court, "it is simply an order which may be countermanded, and payment forbidden by the drawer at any time before it is actually cashed."[7]

14. **The collection of commercial paper.**—Next to the direct transactions with its depositors by check, we may consider the collection of commercial paper, a power which has been held repeatedly to be a necessary incident to a bank's charter, though not expressed therein.[8] To designate a bank, in the body of a note, as the place of payment, does not make the bank so named an agent for either the collection of the note or the receipt of the money, nor can the

[2] Jacks v. Darrin, 3 E. D. Smith 557 (N. Y.).

[3] National Commercial Bank v. Miller & Co., 77 Ala. 168.

[4] Public Grain & Stock Exch. v. Kune, 20 Ill. App. 137.

[5] Pease v. Landauer, 63 Wis. 20, 22 N. W. 847.

[6] Famous Shoe & Clothing Co. v. Crosswhite, 51 Mo. App. 55; reversed on other grounds, 124 Mo. 34.

[7] Mr. Justice Field in Florence Mining Co. v. Brown, 124 U. S. 385, 31 L. Ed. 424.

[8] Keyes v. Bank of Hardin, 52 Mo. App. 323.

maker of the note make the bank an agent of the holder by depositing funds to pay it; unless the payee has endorsed it to the bank or left it for collection with the bank, money received by the bank for the note's payment is taken by it as agent of the maker.[9] But where bonds designate a bank as a place of payment, and the obligor is there at the date of maturity with the necessary funds to pay the bonds, he so far satisfies the contract that he cannot be held for further interest, or costs of suit if the holders have failed to present the bonds.[10] When a note is deposited with a bank for collection, that fact makes the bank the agent of the depositor.[11] As against actions charging it with failure to collect, or loss or damage from the default of its agents, a bank cannot plead want of consideration. "The taking by a bank from a customer, in the usual course of business, of paper for collection, is sufficient evidence of a valuable consideration for the service. The general profits of the receiving bank, from the business between the parties and the accommodation to the customer, must all be considered together, and form a consideration, in the absence of any controlling facts to the contrary, so that the collection of the paper cannot be regarded as a gratuitous favor. The contract, then, becomes one to perform certain duties necessary for the collection of the paper and the protection of the holder. The bank is not merely appointed an attorney, au-

[9] Ward v. Smith, 7 Wall. 447 (U. S.), 19 L. Ed. 207; Adams v. Hackensack Imp. Com., 44 N. J. L. 638; for the opposite holding see Lazier v. Horan, 55 Ia. 75, 7 N. W. 457.

[10] Ward v. Smith, 7 Wall. 447 (U. S.), 19 L. Ed. 207.

[11] Ward v. Smith, 7 Wall. 447 (U. S.), 19 L. Ed. 207.

thorized to select other agents to collect the paper. Its undertaking is to do the thing and not merely to procure it to be done. In such case, the bank is held to agree to answer for any default in the performance of its contract; and, whether the paper is to be collected in the place where the bank is situated, or at a distance, the contract is to use the proper means to collect the paper, and the bank, by employing sub-agents to perform a part of what it has contracted to do, becomes responsible to its customer."[12] So a bank is liable for failure of its correspondent bank to give notice of dishonor, the drawer and indorser having become insolvent.[13] Where the negligence relied on arises from failure to present and protest, and the neglect was that of the notary employed by the bank, the United States Supreme Court has held that the notary alone is liable, and that his employment by the bank makes him the agent of the holder of the paper;[14] but in some of the state courts it is held that the bank is liable for the notary's negligence, on the ground that he is the bank's agent,[15] while in other states particular facts, such as paying the notary a salary, and exacting a bond from him, are held to make the bank liable for his acts.[16]

15. **The quasi-banking of the clearing house.**— The clearing house is usually a voluntary, unincorporated association, having a managing committee,

[12] Mr. Justice Blatchford, in Exchange Natl. Bank v. Third Natl. Bank, 112 U. S. 276, 28 L. Ed. 722.

[13] Same case as in note 12.

[14] Britton v. Niccolls, 104 U. S. 757, 26 L. Ed. 917.

[15] Davey v. Jones, 42 N. J. L. 28.

[16] Gerhardt v. Boatman's Sav. Inst., 38 Mo. 60.

whose members may sue or be sued as and for the clearing house.[17] The daily balances for or against the constituent banks are totalled on a balance sheet,[18] and it may receive and hold collateral securities for the payment of such daily balances.[19] But the holding of such securities, or the issuance of certificates covering daily balances, does not make the clearing house a "bank" in a legal sense.[20] The rules or customs of the clearing house have no effect upon the legal relationship between its constituent banks and their depositors, and the rights and liabilities growing out of that relationship.[21]

Whether clearing houses may by rule limit the time for correcting mistakes as to payment of worthless checks appears to be affirmed in some cases,[22] and denied in others.[23] The members of the clearing house, in their transactions with each other, are not the agents of parties who are not members; each acts as a principal toward the others, and is liable as a principal.[24]

16. **Forgery in relation to banking.**—The crime of forgery, at common law, is the fraudulent making or alteration of a writing to the prejudice of another.[25] "The word is taken metaphorically from the smith, who beateth upon his anvil and forgeth what

[17] Philler v. Yardley, 62 Fed. 645.
[18] Same case as in note 17.
[19] Philler v. Patterson, 168 Pa. 468, 32 Atl. 26.
[20] Crane v. Fourth Str. Natl. Bank, 173 Pa. St. 566, 34 Atl. 296.
[21] Overman v. Hoboken City Bank, 30 N. J. L. 61.
[22] Preston v. Canadian Bank of Commerce, 23 Fed. 179.
[23] Merchants Natl. Bank v. Natl. Eagle Bank, 101 Mass. 281.
[24] Overman v. Hoboken City Bank, 31 N. J. L. 563.
[25] 4 Blackstone Commentaries, p. 247.

fashion and shape he will."[26] There are many statutory definitions of the crime,[27] which extend it to many classes of false writings. The comparative ease with which forged checks can be negotiated makes the consideration of forgery in that connection a matter of importance. Unless the depositor has been guilty of negligence, the bank's liability for the payment of a forged check is absolute; banks are bound to know the signatures of their customers and pay checks purporting to be signed by them at their peril.[28] But the depositor's right of action may be lost through delay in giving the bank notice after he discovers the forgery; the object of that notice being to give the bank opportunity to pursue its legal remedies against the forger or indorsers.[29] Whether the plaintiff has been guilty of such delay as to negative his right of action is a question to be determined in each particular case.[30] So it is the duty of a depositor whose deposit book has been balanced to examine the cancelled checks promptly and accept or repudiate the balance shown. If he fails to do so, and thereby fails to discover a forgery, he is estopped by his conduct to deny knowledge of the forgery as of the date when he had the opportunity of discovering it.[31] The forgery for which the bank is liable may be merely a change of date of the check.[32] It attaches

[26] 3 Coke Institutes, p. 169.

[27] See U. S. Rev. Stats., §§ 5414, 5418.

[28] Hardy v. Chesapeake Bank, 51 Md. 562.

[29] United States v. Natl. Exchange Bank, 45 Fed. 163.

[30] Bank of United States v. Bank of Georgia, 10 Wheat. 333 (U. S.), 6 L. Ed. 334.

[31] Leather Mfgrs. Natl. Bank v. Morgan, 117 U. S. 96, 29 L. Ed. 811.

[32] Crawford v. West Side Bank, 100 N. Y. 50, 2 N. E. 881.

to the payment of a check in which the amount is raised (the signature being genuine) only if the bank has been guilty of negligence.[33] A payee whose endorsement is forged cannot hold the bank for the amount of the check,[34] unless the check has been accepted or certified.[35] The fact that a forgery is not discovered until after the time when the drawee might, under clearing house rules, demand payment from the bank which forwarded the check to the clearing house, is no defense to an action by the drawee against the depositor.[36] As to the right of the holder of a check cashed by a bank upon a forged endorsement to recover the amount from the bank after the bank has collected the amount from the drawee, the rule is that the holder in the absence of fault or laches on his part can recover.[37] So where a bank receives for deposit to a customer's account a check having a forged endorsement of the payee's name, and collecting the amount pays it over to the depositor, it has been held that the payee can recover the amount of the check from the bank.[38] But, upon the ground that no contractual relation exists in such cases between the bank and the payee, the liability of the bank has been denied in other jurisdictions.[39] Whether or not a person whose signature is forged, as maker or endorser of commercial paper, may adopt the signature after he has knowledge of the forgery,

[33] Espy v. Bank of Cincinnati, 18 Wall. 604 (U. S.), 21 L. Ed. 947.
[34] Bank of Republic v. Millard, 10 Wall. 152 (U. S.), 19 L. Ed. 897.
[35] First Natl. Bank v. Whitman, 94 U. S. 343, 24 L. Ed. 229.
[36] National Bank of North America v. Bangs, 106 Mass. 441.
[37] Buckley v. Second Natl. Bank, 35 N. J. L. 400.
[38] Farmer v. People's Bank, 100 Tenn. 187, 47 S. W. 234.
[39] Tibby Bros. Glass Co. v. Farmers' & M. Bank, 220 Pa. St. 1, 69 Atl. 280.

and bind himself to payment by such adoption, is an undetermined question. In Massachusetts it is held that by such adoption the party assumes the note or other instrument as his own and binds himself just as though it had originally been signed by him or by his authority.[40] Such a conclusion has been reached in Missouri where the acknowledgement consisted in the defendant saying, "If it is not my signature, it is very much like it."[41] In other jurisdictions such adoption is condemned on the ground that it is contrary to public policy,[42] or as being void for want of any consideration moving to the party sought to be held as adopter.[43]

17. **Rights and liabilities of trust companies.**— The trust company is, in a general way, the modern incorporated successor of the common law trustee. The legislative establishment of means for incorporating such companies is unrestricted by any rule of public policy.[44] On the other hand, their charters must be strictly construed in determining their corporate powers, and all questions of doubt in that regard must be decided against the corporation.[45] They may be authorized by statute to act in a fiduciary capacity without bond, this privilege resulting from the stability established by the deposit of securities with state officers, state inspection, and like safeguards.[46] Trust companies are, of course, subject to

[40] Wellington v. Jackson, 121 Mass. 157.
[41] Ferry v. Taylor, 33 Mo. 323, 333.
[42] Shisler v. Vandike, 92 Pa. 447.
[43] Workman v. Wright, 33 Ohio St. 405, 409.
[44] Minnesota L. & T. Co. v. Beebe, 40 Minn. 7, 41 N. W. 232.
[45] State v. Lincoln Trust Co., 144 Mo. 562.
[46] Minnesota L. & T. Co. v. Beebe, 40 Minn. 7, 41 N. W. 232.

the foreign corporation laws of the several states,[47] and strictly subject to the restrictions placed upon their dealings in commercial paper by statute in the states of their incorporation.[48] Such companies, organized under the Pennsylvania Act of May 9, 1889, P. L. 157, having general powers "to execute trusts of every description," have capacity to act as the committee of a lunatic.[49] A statute authorizing such companies to act as assignee without bond is not in contravention of public policy,[50] and so of a statute (Pa. Act June 24, 1895, P. L. 248) authorizing receivers and other trust officers to include as part of their expenses in executing the trust, reasonable premiums paid surety companies for their official bonds;[51] but such payments cannot be taxed as costs in favor of a successful plaintiff in replevin, the payment being to the surety company for executing the replevin bond.[52] Where a surety company contracts to act as surety on a government contract for a fixed term of years, and breaches its contract, it is liable to the contractor for his damages resulting from obtaining other sureties at an increased cost.[53]

18. **Collateral securities.**—The relationship of the bank to the depositor of collateral securities is governed by the general law of bailments. If bonds or other valuables are merely deposited with the bank for safe-keeping, without payment to the bank for

[47] United States Trust Co. v. Lee, 73 Ill. 142.
[48] Pratt v. Short, 79 N. Y. 437.
[49] Equitable Trust Co. v. Garis, 190 Pa. 544, 42 Atl. 1022.
[50] Roane Iron Co. v. Wisconsin Trust Co., 99 Wis. 273, 74 N. W. 818.
[51] In re Clark's Estate, 195 Pa. 520, 46 Atl. 127.
[52] Bick v. Reese, 52 Hun 125 (N. Y.), 5 N. Y. Supp. 121.
[53] Samuels v. Fidelity & C. Co., 49 Hun 122 (N. Y.), 1 N. Y. Supp. 850.

their care and custody, and exclusively for the benefit of the depositor, the only obligation resting upon the bank is to exercise over the chattels the reasonable care which "men of common prudence usually bestow for the protection of their own property of a similar character."[54] The degree of negligence which will subject the bank to liability for the loss of the chattel is gross negligence.[55] But where bonds so deposited are subsequently treated as security for overdrafts they become collateral securities, and a higher degree of care is exacted of the bank. The deposit is changed from a gratuitous bailment to a bailment for the mutual benefit of both parties and the bank becomes liable for the loss of the property if caused by its neglect, though that neglect does not amount to gross negligence.[56] Until comparatively recent times it was held that when property was stolen from a bank by one of its officers or clerks, the bank was not liable, because in the theft the clerk or officer was acting without the scope of his authority.[57] But that doctrine is now abandoned and the bank is held liable if the theft occurs in consequence of its failure to exercise such care and diligence in the custody and keeping of the property "as banks of common prudence in like situation and business usually bestow in the custody and keeping of similar property belonging to themselves," and the measure of damages in an action based on the loss is the mar-

[54] Preston v. Prather, 137 U. S. 604, 34 L. Ed. 790.

[55] Same case as in note 54.

[56] Same case as in note 54.

[57] Foster v. Essex Bank, 17 Mass. 479; Scott v. National Bank of Chester Valley, 72 Pa. 471.

ket value of the property at the time it was stolen.[58] So where the bank's directors neglect its affairs, failing to hold meetings as provided by by-laws, and failing to examine securities, the bank is liable for collateral securities stolen by its president.[59] When a deposit of collateral is made to secure loans or discounts of the depositor, the payment of the loans does not alter the character of the bailment, and the bank's liability for loss remains the same in character until the property is finally returned to the depositor.[60] It is not a defense to an action for damages for the loss of bonds deposited with a bank that the acceptance of the deposit was not authorized by the bank's charter, where the bank is accustomed to accept special deposits of the kind and the practice is known to its directors,[61] and this rule extends to national as well as state banks.[62]

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Morse on Banks and Banking is a comprehensive work upon the subjects indicated in its title; several editions of the work have appeared, as is also the case as to *Daniel* on Negotiable Instruments, treating of commercial paper generally. In the latter field, *Story* on Bills of Exchange has also gone through several editions.

[58] Third Natl. Bank v. Boyd, 44 Md. 47.
[59] Cutting v. Marlor, 78 N. Y. 454.
[60] Ouderkirk v. Central Natl. Bank, 119 N. Y. 263, 23 N. E. 875.
[61] Manhattan Bank v. Walker, 130 U. S. 267, 32 L. Ed. 959.
[62] First Natl. Bank v. Graham, 100 U. S. 699, 25 L. Ed. 750.

LAW OF RECEIVERS

BY

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1. **Definition.**—Mr. Pomeroy, in substance, defines a receiver as "a person standing indifferent between the parties, appointed by the court as a quasi-officer or its representative, to hold, manage, control and deal with the property which is the subject-matter of or involved in the controversy, under the court's direction, either (a) where there is no one entitled competent thus to hold it; or (b) where two or more litigants are equally entitled, but it is not just and proper that either of them should retain it under his control; or (c) where a person is legally entitled, but there is danger of his misapplying or misusing it; or (d) where he is appointed in like manner and under like circumstances for the purpose of carrying into effect a decree of court concerning the property;" giving instances in each case.[1]

2. **An equitable remedy.**—The appointment of a receiver is part of the jurisdiction of equity and is based on the inadequacy of the remedy at law, being intended to prevent injury to the thing in controversy

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[1] Pomeroy, Equity Jurisprudence (3rd ed.), § 1330.

and to preserve it *pendente lite* (pending litigation), for the security of all parties in interest to be finally disposed of as the court may direct. Such appointment is a high power, never exercised where there exists any other safe or expedient remedy. It is a matter resting in the sound discretion of the court. The appointment is generally made either to prevent fraud, protect property from injury, or preserve it from destruction; but the mere allegation of these facts is not sufficient to authorize a court to make the appointment; the plaintiff must establish such facts and make out a strong case for relief before it will be made.[2]

In most states there are statutes conferring jurisdiction to appoint receivers on particular courts or in particular proceedings, and these should be consulted.

3. **Essentials.**—The pendency of a suit is generally essential to authorize such appointment save in cases of infants, idiots and lunatics; and the complainant must have and show an apparent cause of action upon which there is a likelihood of recovery coupled with the fact of imminent danger or peril to the property.

One of the prerequisites is generally that any remedy existing at law must be exhausted, and a receiver will not be appointed where the sole question is one of law or the party's alleged right may be asserted in a common law court. Exceptions exist

[2] Milwaukee, etc., R. v. Soutter, 154 U. S. 541; Dawson v. Parsons, 137 N. Y. 605; Nash v. Meggett, 89 Wis. 486. Compare, Jones v. Thorne, 80 N. C. 72.

where relief is afforded in special circumstances of an equitable nature and appealing strongly to the court's conscience. Merely overlooking or neglecting legal rights will not suffice. The plaintiff must show: (a) either that he has a clear right to the property itself, or some lien upon it, or that it constitutes a special fund to which he may rightfully resort to satisfy his claim; and (b) the defendant's possession thereof was obtained by fraud, or that the property itself, or its income, is in danger of being lost by the defendant's neglect, waste, misconduct or insolvency.[3]

A court of equity will not appoint a receiver for a debtor's property on the application of general creditors whose claims have not been reduced to judgment and who have obtained no lien on such property. Chancellor Woolworth says that it is "almost a matter of course upon a judgment creditor's bill, to appoint a receiver to collect and preserve the property pending the litigation."

Where all of several persons are equally entitled to have possession, but where from the circumstances it is not just or proper that any one should have exclusive possession, a receiver may be appointed; as, for example, in partnership matters which are in dispute. Again, a receiver may be appointed to prevent a fraudulent transfer or to take control of property fraudulently transferred, as such transaction sufficiently shows danger of loss.

In a proper case a receiver may be appointed to take charge of mortgaged property pending foreclosure. But there should be an imperative necessity

[3] Wanneker v. Hitchcock, 38 Fed. 383.

therefor. The court has inherent power to appoint a receiver *pendente lite* in foreclosure proceedings, but to obtain relief the case must clearly show the necessity for it. The two principal grounds in obtaining appointments of receivers to collect rents, etc., are (a) the inadequacy of the security to discharge the mortgage debt, and (b) the insolvency of the mortgagor, or that a deficiency judgment would likely be unavailing. This is especially true where taxes are allowed to become delinquent and waste is being committed.[4]

In spite of the court's reluctance to supplant a trustee by a receiver, still if it is shown that a trustee has been guilty of positive misconduct or waste, or has improperly disposed of his trust estate, or has an undue partiality toward one of several conflicting parties, or that the trust estate is liable to be wasted or destroyed, an equity court will interfere and appoint a receiver on proper application.[5]

In a divorce proceeding a receiver may be appointed in some cases.[6] A receiver will not be appointed in a proceeding to dissolve a partnership where the partnership is denied, unless the court is satisfied that there is in fact a partnership between the parties or that the fund is in danger.

Equity courts possess authority to appoint receivers of corporations in proper cases, independent of statute. While there is apparent conflict of decisions as to appointing receivers for corporations be-

[4] Connelly v. Dickson, 76 Ind. 440; Schreiber v. Carey, 48 Wis. 208.

[5] Baker v. Backus, 32 Ill. 79. See notes to 72 Am. St. Rep. 48, 69.

[6] Petaluma S. Bank v. Superior Court, 111 Cal. 488; Barker v. Dayton, 28 Wis. 367.

cause of misconduct of officers and directors, it is a generally recognized rule that such appointment will be made only when necessary to preserve the property or right of creditors or stockholders. Mere misconduct is insufficient, as such officer's misconduct may be equitably restrained or he may be removed. One cannot have a receiver appointed over his own property, and this applies to corporations, insolvent and otherwise. In an action of specific performance, the appointment of a receiver is authorized where there is danger of loss from waste, insolvency of the defendant, or other peril to the property. Temporary receivers may be appointed *pendente lite* in proper cases.

4. **Notice of application.**—Ordinarily a motion for the appointment of a receiver must be upon notice to the opposite party. To justify the appointment of a receiver without notice to interested and necessary parties, it must appear that irreparable injury will result from delay. The giving of notice, and the circumstances justifying its omission, are often matters of statutory regulation and such statutes must be followed.

5. **Qualification—Tenure.**—The person appointed receiver should be independent, disinterested, impartial and indifferent between the parties; he should not be involved in the litigation or be the partisan or representative of any of the parties litigant. He is not supposed to represent the peculiar interest of one class, much less to represent one interest out of a class of interests. However well qualified otherwise, interest disqualifies one to serve as receiver.

Where an order is made appointing a receiver of an insolvent corporation, the presumption is that all things were done required by the statute to be done, in order to authorize the court to make such order.[7] Officers and stockholders of corporations are not, as such, ineligible to appointment as receivers thereof, though courts will not usually make such appointments. A receiver is never permitted to take charge of property without having first given bond with approved surety, except in special cases. Such bond must be signed by sureties, sufficient in number and property, payable to the clerk of the court or to the state, and conditioned faithfully to perform the duties pertaining to the trust and to obey the orders of the court and fully to account for all the funds and property coming into his hands. He will be liable on his bond for any misfeasance of office or other misfeasance of office, occasioning damage. A surety will be liable, ordinarily, only to the extent of his bond. Whatever he is required to pay under such bond, he may recover from the receiver personally.[8]

The appointment of a receiver continues during the pendency of the suit unless his term of office is limited by the order appointing him. The removal of a receiver is discretionary with the court. The proper court may appoint a successor to a receiver whose resignation he has accepted.

6. **Title and possession of property.**—While a court may appoint a receiver with authority to take possession of property in another state or county, it

[7] Potter v. Merchants' Bank, 28 N. Y. 641, 86 Am. Dec. 273.
[8] 23 Amer. & Eng. Enc. of Law (2nd ed.), p. 1114.

is always true that such appointment confers no legal authority which he can exercise over such property without the aid of the courts in whose jurisdiction it is found. The appointment of its own force, carries a *right* to possess the property but it gives him no *power* to compel the recognition of such right beyond the jurisdiction of the court appointing him. He has officially no personal interest in the property beyond that springing from his responsibility correctly and properly to discharge his duties. His possession is not, strictly speaking, adverse to either litigant, and gives no advantage to the one applying for a receiver, over other rightful claimants of the property.

A receiver may be appointed in proper cases over corporeal or incorporeal real or personal property. Ordinarily receivers will not be appointed to take charge of property already assigned for the benefit of creditors. In special cases a receiver may be appointed.[9] A title of a receiver vests by relation from the date of the order of his appointment. "By his appointment a receiver becomes an officer of the court. The property is constructively in the possession of the court, and in the discharge of his duties he is subject to the direction, control and protection of the court. His authority is derived entirely from the court, and both his powers and duties are prescribed by it."[10] And at every step he is subject to the control and supervision of such court in his management of the property or funds placed in his charge,

[9] Powers v. Paper Co., 60 Wis. 23, State v. Bank of New England, 55 Minn. 139; both under statutes.

[10] Merwin, Equity, § 1002.

and it is the court's duty to protect and preserve the possession by its receiver, and to prevent all interference with him in the performance of his official functions and duties. As soon as appointed a receiver should make out a complete inventory of the property and effects coming into his hands. This is often governed by statute, and such statute should, of course, be consulted and followed.

An order appointing a receiver cannot be collaterally attacked. "Inasmuch as the receiver is an officer of the court, any unlawful interference with him in the performance of his duties, or in his possession of the property, is deemed a contempt of the court, and will be punished as such."[11] That one interfering was claiming paramount to or under the right which the receiver was appointed to protect makes no difference; a person who thinks he has a right paramount to that of the receiver must apply to the court for leave to assert such right before asserting it of his own motion. Generally, the receiver is instructed by the court as to the manner of proceeding in the discharge of his duties; this is usually in the order of appointment, but in special instances he is entitled to specific advice from the court on proper application.

7. **Power to create liens.**—"A receiver has no inherent power in and of himself but only such as the court appointing him has authority to confer. This limitation on a receiver's power applies to his creating liens upon property in his possession. The court alone has power to give the receiver authority to cre-

[11] Merwin, Equity, § 1010.

ate liens. A receiver merely by virtue of his general authority has no such power."[12] At common law a receiver has no powers except such as are conferred on him by the order appointing him and the course and practice of the court. He has no power, without the court's approval, to make a contract which will bind the trust estate. But an equitable court has power through its appointed receiver to create liens upon the property of a quasi-public corporation under its control superior to those of prior mortgages.

8. **Management of property.**—"The receiver is bound to act in good faith and with a proper degree of diligence and if property is lost through his fault or neglect, he may be made liable for it. When the property is lost or injured by any negligence or dishonest execution of the trust, he is liable in damages, but he is not, of course, responsible, because there has been, without his fault, any embezzlement or theft. He is bound to such ordinary diligence as belongs to a prudent and honest discharge of his duties and such as is required from all persons who receive compensation for their services."[13]

The appointment of a receiver is for the benefit and on behalf of all parties in interest. The court has the power to appoint a receiver to carry on a business, and will exercise it on proper occasions. When a receiver is appointed for a business being carried on by an individual, firm, or corporation, he must usually proceed to wind it up rather than indefinitely continue it. But it may be carried on under the or-

[12] Note to 83 Amer. St. Rep. 72, citing cases.
[13] Bouvier's Institutes, § 3812.

der of the court when necessary to preserve the existing status, considering the character of the property, the uses to which it is applicable and to what extent its use in some manner is necessary to its preservation. Receivers have a certain amount of discretionary power in managing and controlling property in their care and when they exercise such discretion carefully and in good faith their acts will ordinarily be confirmed. The limits of such discretion depend largely on the circumstances of the case and where a receiver is appointed to carry on the business temporarily or indefinitely many of the details must necessarily be left to his judgment, as it would be impracticable to apply in every instance to the court for directions.[14]

A receiver is entitled to be repaid actual disbursements prudently made or incurred, in the course of handling the trust property. Thus, a receiver of hotel property who conducts the hotel, is not personally responsible for a loss of $25, caused by cashing a worthless draft for one of the guests where it appears that making such advances to guests is not unusual among hotel managers.[15]

9. **Receivers' certificates.**—"Where a railroad is in a receiver's hands and its income is insufficient to conserve the road *pendente lite* he will as a rule be authorized to borrow money upon the property's credit, and issue for security of the payment thereof debentures or certificates of indebtedness; these are generally made a first lien upon the road's entire

[14] 23 Amer. & Eng. Enc. of Law (2nd ed.), p. 1063.
[15] Heffron v. Rice, 149 Ill. 216, 36 N. E. 562, 41 Am. St. Rep., 271.

property, income and franchises, and hence take priority over first mortgage liens and all other creditors; as the trust income is generally insufficient to pay such certificates they are usually paid out of foreclosure proceeds and take precedence over all other debts in distribution. * * * The court's power to authorize such certificates is derived from its duty to protect and preserve the trust property in its hands, * * * and is sparingly exercised and is strictly construed. Such certificates are usually limited to necessary operating expenses. They will not as a rule be authorized for new construction or to complete unfinished portions, or to enable the receiver to make permanent improvements not necessary to keep the road going. * * * Such certificates are not negotiable as ordinary commercial paper is."[16] The purchaser of a receiver's certificate properly issued is not obliged to see to the application of the money by the receiver as directed by the court.

10. **Priority of liens.**—The object being to preserve the property for the benefit of all interested, a business may be continued when such interests are thereby preserved. A receiver takes the property subject to existing liens and equities; his exclusive possession does not interfere with or disturb pre-existing liens, preferences or priorities. A receiver should secure all available assets to pay creditors. "Appointing a receiver vests in the court no absolute control over the property and no general authority to displace vested contract liens. No court can interfere

[16] 24 Amer. & Eng. Enc. of Law (2nd ed.), p. 38; Wallace v. Loomis, 97 U. S. 146.

with the property held by another court through a receiver, but may establish by its judgment a debt against the receivership, which must be recognized even by the court granting the receiver, and is not open to revision by it, if the court had jurisdiction of the subject-matter and of the parties. Such judgment, however, merely establishes the existence and extent of the claim; the manner in which it shall be paid is under the control of the court which appointed the receiver."[17]

A mechanic's lien is not affected by such appointment. Appointing a receiver in a suit for a partnership dissolution and accounting will not affect creditors' claims which have previously become liens. Liens on property sold by a receiver are not ordinarily divested thereby.[18] Property held by a receiver is subject to a tax lien.

The following is a summary of an exhaustive editorial note to a leading case on "the priority of claims against property in the hands of a receiver over recorded liens." (a) Most cases determine such priorities on equitable principles, rather than mere definition. (b) In claims against railroads, arising prior to appointment, those for labor and material are usually given priority over mortgage liens, where there has been a diversion of earnings to the latter's benefit; some cases hold otherwise where there has been no diversion. Such priority is commonly allowed where the labor and material were necessary to keep

[17] American Trust & Savings Bank v. McGettigan, 152 Ind. 582, 71 Am. State Rep. 345, 356, 361.

[18] Foundry Co. v. Nail Co., 148 Ind. 372; Hoffman v. Schroyer, 143 Ill. 598.

the railroad going, irrespective of diversion. A non-foreclosing mortgagee leaving the property in the mortgagor's hands and applying for a receiver is required to do equity, and permit such priority. Claims not directly related to the receivership property or arising elsewhere or not coming within the court's time limit, or arising from the sale of property reclaimed by its vendor, are denied preferences. Authorities differ as to priorities for money advanced. Generally lessors of rolling stock or rights of way are classed with laborers and material men. But damages to property or for personal injuries have no priority over mortgages, being unnecessary rather than necessary expense. Ordinarily officers have no preference as to salaries in arrears. By weight of authority, construction work claims have no priority, not counting as work and material; they should be paid out of sale proceeds or stocks and bonds. If within a protective statute, the claimant may be given priority.

(c) Where claims arise during the receivership, if for labor and supplies furnished the receiver to run the road, they are usually deemed expenses and preferred; so also for money advanced. Reasonable rental is given priority, not necessarily measured at the contract rate, however, and then only for actual use. Damages have been held chargeable as expenses, payable out of earnings, though sometimes limited to profits. Counsel fees for services rendered the receiver are a prior lien against the earnings and the property itself. The receiver's compensation is sometimes treated so; as also insurance premiums. Taxes

are preferred. Certificates to raise funds for operating expenses are prior liens. Statutory liens are, of course, protected. (d) Gas, water, irrigation and other companies having condemnation powers are usually put on the same basis as railroads. (e) By weight of authority, the rule applicable to railroads regarding displacement of mortgage liens does not govern private corporations. This is particularly true as to claims under (b) supra, and applies in a limited way to those under (c) supra.[19]

11. **Allowing and paying claims.**—In some jurisdictions it is held to be the receiver's right to pass in the first instance upon the validity and propriety of claims presented, subject to the control and direction of the court. The court may decree that all claims in order to participate in a receiver's fund must be filed within a certain period, and this right has often been sanctioned by statute.

12. **Suits by receivers.**—A receiver succeeds to all the rights of action belonging to him or them whose property he is appointed to take over, and he occupies generally and substantially the same relations which were occupied by the original parties. Contract relations and rights of action remain unchanged and these may be enforced by the receiver by appropriate proceedings. Such right of action in the receiver dates back to the accrual of the right in the party for whose property he is receiver.

A receiver cannot sue without leave of the court appointing him. A contrary rule sometimes obtains

[19] First Nat'l Bank v. Cook, 12 Wyo. 492, 76 Pac. 674, 2 L. R. A. (n. s.), 1012.

by statute.[20] "A receiver has no extra-territorial power of official action, nor can the court appointing him confer such authority, or enable him to go into a foreign jurisdiction to take possession of a debtor's property, nor any power which can give him, upon principles of comity, a privilege to sue in a foreign court or another jurisdiction, as the judgment creditor himself might have done, where his debtor may be amenable to the tribunal which the creditor may seek."[21] State comity does not require one state's courts to permit receivers appointed by another state's court to exercise privileges detrimental to the former's citizens while pursuing appropriate legal remedies there. "The principle of comity, however, is restricted to cases where no vested or acquired rights of the citizens of the state extending such comity will be affected injuriously."[22]

The court appointing a receiver may empower him to compromise claims or actions by or against the estate when for the best interests of all concerned. He may receive moneys payable on contract before they fall due, and may satisfy a mortgage if paid before maturity. Likewise he has been given the option of considering as absolute payment, securities deposited as collateral.

13. **Suits against receivers.**—A receiver cannot ordinarily be sued without first obtaining the permission of the court which appointed him. "It is a commonly accepted doctrine that unless there is a

[20] Hanke v. Blattner, 34 Ill. App. 394; Hayes v. Brotzman, 46 Md. 519.
[21] Booth v. Clark, 17 How. 322-333 (U. S.).
[22] Beach, Receivers, §§ 17, 18 citing cases.

special authority by statute, a suit cannot be brought against a receiver touching the property rightfully in his charge nor for any malfeasance as to parties or others without the permission of the appointing court."[23] A suit without leave is ordinarily only a question of contempt and does not affect the right involved in the suit. By act of Congress an action may be brought in a state court against a federal receiver without obtaining leave of the federal court. A federal receiver for a railroad company may be sued in a state court without previous leave of the appointing court, for damages on account of the death of the receiver's employe caused by the receiver's negligence in operating the railroad.

As a general rule the liability of a receiver is solely official except where he is personally culpable. Hence, in an action against a receiver official, a personal judgment is erroneous. It must be entered against him as receiver, and then it is payable out of funds in his control as such and enforceable against property in his custody.

An equity court appointing a receiver may entertain an intervening petition for damages occasioned by the receiver's alleged tort, adjudicate it and make a final order for its payment. If a corporation itself would have been liable under the statute affecting the fellow-servant rule, a receiver thereof will be liable officially.[24] A receiver's liability for his employes' torts, he being free from fault, is in his official capacity and not personal.

[23] Note to 74 Amer. State Rep. 286, citing numerous cases.

[24] Shedd v. Seefeld, 230 Ill. 118, 82 N. E. 580, 120 Amer. St. Rep. 269, with exhaustive note.

Independently of statute, a receiver cannot be garnished without leave of the appointing court. Such leave may be granted. Improper garnishment may be enjoined. After a receiver is appointed, ordinarily a suit will not lie against a debtor in that jurisdiction involving property in the receiver's hands.[25]

14. **Judgments against receivers.**—A judgment against a receiver as such concludes all whom he represents. A state court judgment against a federal court receiver is, by weight of authority, conclusive as to the existence and amount of the plaintiff's claim. A judgment against a receiver as such creates no personal liability and is merely payable in due course of the receivership. An execution will not lie. Enforcement is only by consent and direction of the court or as specially provided by statute.[26]

15. **Receivers selling property.**—An equity court appointing a receiver of property *pendente lite* to determine rights of parties thereto, has power to order property sold where it appears that it is not paying receiver's expenses, and that such sale will be advantageous to all interested. Corporate property may be sold to the company's directors if in good faith and for an adequate price. A corporation's judgment creditors may bid in the property at receiver's sale, either unitedly or by one for all. Either partner may buy in the firm property if by so doing the best price is obtained. Only such title and interest passes on a receiver's sale as was owned by the one whose in-

[25] Gilman v. Ketcham, 84 Wis. 60, 36 Amer. St. Rep. 899; First Nat'l Bank v. Dovetail Body & Gear Co., 143 Ind. 534.

[26] Painter v. Painter, 138 Cal. 231, 71 Pac. 90.

terest is being sold. The rule of *caveat emptor* (let the purchaser take care) is strictly applied, and it is for the buyer to discover what interest he is buying. After confirmation a receiver's sale cannot be collaterally attacked. But such sale will be set aside when based on material errors as to amounts and value of the property, or where an advertisement varies materially from the terms of the original order of sale, or where there has been a fraudulent or collusive sale and the rights of innocent third parties have not intervened. Such attacks are not considered collateral.[27]

16. **Accounting by receivers.**—The court appointing a receiver, under whose direction he acts, may require him to account at any time at its discretion; but no other court has jurisdiction to require this. A receiver using money in his hands is chargeable with interest. If he sells property, he presumably receives the money and is liable for the amount thereof. The amount of counsel fees to be allowed a special receiver is within the court's discretion.

17. **Compensation of receivers.**—When one is appointed receiver of the property of another, or of a firm or corporation, he is usually entitled to compensation for his services in preserving the property and in conducting the business, if so authorized and directed. In some states the rate of compensation is fixed by statute and these, of course, control. In the absence of such statute, the amount to be allowed the receiver is a matter resting in the sound discretion of the court appointing him and in such case the al-

[27] 23 Amer. & Eng. Enc. of Law (2nd ed.), pp. 1081-1083.

lowance will not be disturbed on appeal except where there has been a manifest abuse of discretion. The sum fixed depends largely on the special facts of each case, having regard to the amount of labor done, the character of the services rendered, the value and character of the property involved and of the business (if any) conducted, and the practical benefits ensuing from the services rendered by the receiver and his duly employed assistants.

Where a receiver is appointed without jurisdiction, and without consent, he is generally held not entitled to compensation for expenses from funds in his possession.[28] Some cases hold that in case of insufficient funds the receiver may look to those who procured his appointment for his compensation. Where a decree is finally entered against a plaintiff who has wrongfully procured the appointment of a receiver, the court may in its discretion tax the receivership costs against the plaintiff.

18. **Foreign receivers.**[29]—Where the parties litigant reside in one state its courts have power to appoint a receiver to take possession of defendant's property in another state, but such court has no power to remove or cause to be removed personal property from another state so as to bring it within the state wherein the receiver has been appointed.

"While there are authorities of great weight which seem to hold that a receiver appointed in one jurisdiction will not be permitted to maintain a suit in a

[28] State v. People's United States Bank, 197 Mo. 605, 95 S. W. 867. There are many contrary cases: Cutter v. Pollock, 4 N. D. 205, 59 N. W. 1062, 25 L. R. A. 377, 50 Am. St. Rep. 644.

[29] See also § 12.

foreign state, the generally prevailing doctrine upon which all the decisions seem to be harmonious is, that upon the principles of comity the courts of the jurisdiction in which the property or fund is situate will recognize the rights of the receiver so far as to aid him in reducing it to possession, unless to do so would in some way violate the local policy or interfere with the rights of resident creditors. * * * The rule may be considered established that a receiver may invoke the aid of a foreign court in obtaining possession of property or funds within its jurisdiction to which he is entitled, but aid will only be extended as against those who were parties to, or in some way in privity with, the proceedings in the course of which his appointment was made, or who are in possession of the property or fund to which the receiver has a right, and not against creditors of a non-resident debtor, who are seeking to subject the property or fund to the payment of their debts, by proceedings instituted for that purpose."[30]

A receiver appointed in one state can sue in another as such only by comity, and this principle will not be so far extended as to allow replevin of a debtor's property attached in another state, even though when attached it was in the receiver's actual possession and had been brought by him from the state where appointed.

19. **Ancillary receiver.**—Where a receiver has been appointed in one state court, the court of another state may, when necessary, appoint an ancillary receiver in the latter state. As a rule it is within the

[30] Catlin v. Wilcox etc. Co., 123 Ind. 477.

discretion of the latter court whether to appoint an ancillary receiver, or an independent domestic receiver for the assets found within the domestic jurisdiction, and also whether the latter court will appoint as ancillary receiver the one previously appointed or some one else designated by the court. Such ancillary receiver has only the powers conferred on him by the order appointing him, but he should be given the same remedies and aid that the court originally appointing conferred. He is, however, subject to the jurisdiction of each court so far as the property and his acts are within such court's jurisdiction.

An assignee of an insolvent corporation may intervene and be heard on application for the appointment of a receiver of the corporation property in another state. Where a receiver has been appointed in one state, the United States District Court will, on proper cause, appoint an ancillary receiver in another state.[31]

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[31] Williams v. Hintermeister, 26 Fed. 889; 3 Kulp. 499 (Pa.).

QUIZ QUESTIONS

LAW OF PRIVATE CORPORATIONS

(The numbers refer to the numbered sections in the text.)

1. Trace the historical development of the private corporation.
2. Of what importance is the corporation in modern life?
3. Give three famous definitions of corporations.
4. In what sense is a corporation a reality, and in what sense is it a fiction?
5. Distinguish between the corporation and the partnership.
6. What is the difference between a corporation and a joint-stock company?
7. Great Britain charters a corporation and gives to it every corporate attribute, but declares that it shall not be considered as a corporation. May the state of New York lawfully tax this association under an act taxing corporations?
8. What are the advantages of incorporation?
9. Action to escheat certain land purchased and owned by corporation Y, incorporated by F, G and H for the purpose of acquiring and holding title to lands. F, G and H were aliens and the sole incorporators and stockholders. The statute of the state where the corporation was incorporated, provides that "no alien shall acquire, own or hold in whole or in part, directly or indirectly, any real estate." The corporation demurs. Who wins and why?
10. A tract of land was divided into building lots, each deed of a lot containing a covenant that title should never vest in a person or persons of Japanese birth or descent. Subsequently, several of the lots were conveyed to a

corporation whose only stockholders were Japanese, which knew, when it purchased, of the restriction. Is the corporation entitled to hold the land?

11-12. Suit in equity by the United States to restrain a railway company from transporting the copper of a corporation owning extensive copper mines and engaged in the mining and selling of copper. The bill alleged that the copper company was formed in the interest of the railway company and that all its stock was owned by the railway company. A federal statute prohibited any railway company from transporting in interstate commerce any commodity "which it may own in whole or in part, or in which it may have an interest, direct or indirect." Defendant demurred. Who is entitled to judgment?

13. A statute forbade any person from operating a saloon within 200 feet of a church. The X corporation began the operation of its saloon next door to a church, contending that it was not subject to the statute. Who wins and why?

14. Suit in the federal court by X corporation incorporated under the laws of the state of Illinois, against Y, a citizen of Iowa. Has the federal court, of the appropriate federal district, jurisdiction?

15-16. How may corporations be classified?

17. A, B and C meet and formally agree to act as a corporation. Are they a corporation?

18. How may sovereign sanction to the creation of a corporation be evidenced?

19. The state legislature of Nevada, without application from A, B and C, incorporates them into a company for the purchase and sale of dry goods. Is this lawful?

20. Discuss the creation of corporations by special act.

21. The state legislature of Indiana passed an act conferring a corporate franchise upon A, B and C; before they accepted, a new constitutional provision was adopted that corporations could not be created by special acts of this sort, but might only be formed under general laws. A, B and C nevertheless proceed to do business as a corporation. Have they a right to do this?

22. What evils resulted from incorporation by special act?
23. What constitutes the charter of a corporation where it is organized under a general law?
24. Discuss the delegation of the power to create corporations by the state legislature.
25. What provisions are ordinarily found in general incorporation laws?
26-27. The state of Illinois confers upon X, Y and Z every conceivable attribute of a corporation. Are they to be regarded as a corporation?
28. The Congress of the United States determines to build a canal at Panama to connect the Atlantic with the Pacific Ocean. May it lawfully incorporate a company to carry out this project?
29. A, B and C are doing business in the state of New York as the "Arthur Johnson Sporting Goods Company," a corporation. As such, they have done a large business and acquired a very enviable reputation. Will the secretary of state issue to P, Q and R a license to incorporate under the name of the "Arthur N. Johnson Sporting Goods Company"?
30. Define a corporation de jure.
31. Where a state statute requires that one-half of the entire capital stock of a corporation must be subscribed and one-fourth actually paid in, are these conditions precedent to corporate existence?
32. Give an illustration of a provision which is merely directory, and distinguish it from a mandatory provision.
33. Discuss the de facto doctrine in general.
34. Enumerate the conditions under which a de facto corporation may be deemed to exist.
35. A, B and C, believing themselves to be incorporated as the Y corporation, take title to a piece of land. A third party R, discovers that they have failed to file their incorporation certificate as required by statute, and though personally disinterested, brings an action to forfeit the corporate title, claiming that it is not legally organized and cannot hold real estate. Does he win?
36. A, B and C proceed to organize a corporation in a territory where there is no law in existence authorizing the

formation of corporations. Are they a corporation de facto?

37. Can there be a corporation de facto under an unconstitutional statute? If so, why? If not, why not?
38. Discuss the necessity of good faith in the formation of a private corporation, and indicate the effects, if any, of its absence.
39-40. A, B and C agree to form a corporation and draw up and sign articles of incorporation, but do nothing further. Acting as a corporation they sell goods to D. They sue D for non-payment, as a corporation, and in the corporate name. D defends. Is his defense good?
41. What evidence is required of corporate user?
42. Action for goods sold and delivered against A, B and C, the sole stockholders of a company doing business under the name of "John Doe Company." A, B and C had instructed their attorney to form a corporation. He had filed the certificate of incorporation, but had failed to comply with some of the provisions of the law sufficiently to make it a de jure corporation. The goods were charged on plaintiff's books to "John Doe Company." Plaintiff knew that A, B and C were associated together in the business, but he did not know whether they were conducting their business as a partnership or corporation. Is plaintiff entitled to judgment?
43. The New York City Railway Co. is attempting to take your property in condemnation proceedings in order to build a suitable depot. You discover that there was a slip-up in its organization. On this ground you contend that it does not possess the right to take your property. Do you win?
44. Discuss the estoppel doctrine, as applied to imperfectly or defectively organized corporations.
45. X sells goods to the Y corporation and takes its promissory note in payment. Subsequently X discovers that the corporation had failed to file its incorporation license in the office of the Recorder of the County where its principal business office was located, as required by statute. May X sue the stockholders in the Y corporation on his claim?

46. X, a stockholder in the Y corporation sells it ten tons of coal. X later discovers that the corporation is imperfectly organized and seeks to hold his fellow stockholders personally liable. May X do so?

47-48. Discuss both the value of, and the limitations upon, the doctrine of estoppel to deny corporate existence.

49. Define promoters and indicate their functions.

50. X, the promoter of a corporation, while engaged in forming the company purchases certain real estate for $10,000. His idea was to resell this property to the corporation at an advance in price. Subsequently he does so, obtaining $20,000 from the corporation. Is this lawful?

51. Discuss the necessity of full disclosure by promoters.

52. John Doe wishes to sell machinery to a proposed corporation. He promises P, a promoter that he will give P $500 if P can bring this about. P uses his influence, and when the corporation is organized, persuades it to purchase the machinery. The corporation subsequently ascertains the fact and sues P to recover the $500. Who gets judgment and why?

53. X, a promoter of a mine, tells the subscribers in his prospectus that the mine is turning out fifty tons of ore a week and has the most splendid prospects possible. In fact, operations had not yet been begun. What is the liability of X?

54. X and Y, promoters of a company, spend all of their time for two years in organizing it and putting it upon a going basis. The corporation refuses to pay them for their services. X and Y sue. Do they win or lose?

55. P, a promoter, enters into a contract with N on behalf of a corporation as yet unorganized, which P is promoting, whereby the corporation agrees to purchase from N one hundred tons of steel rail. When the corporation comes into existence, its board of directors repudiate this contract. N sues for damages for breach of contract. The corporation defends. Who gets judgment and for what reasons?

56. May a corporation, upon its organization, ratify contracts made by its promoters on its behalf before it was formed? Give reasons.

57. A and B, lawyers, rendered valuable services to a company before its organization in drafting its incorporation papers and securing its charter. After the corporation was organized, it refused to pay them for their services. They sue to recover the reasonable value of their work. Are they successful, and why, if they are? Why not, if they are not?
58. To what extent are promoters personally liable upon contracts made by them for a company which they are engaged in floating?
59. What is the nature of the agreement of association between incorporators?
60. Who may subscribe to stock in a corporation?
61. Distinguish a subscriber from a stockholder.
62. A subscribes for ten shares of stock in the X corporation and pays therefor. No certificate is ever issued to him. Is he a stockholder?
63. Discuss fully the nature and characteristics of a contract of subscription to the capital stock of a corporation to be thereafter formed.
64. X subscribes for ten shares of stock in a corporation which is to be organized to operate a theater in his home town. Before the theatrical company is incorporated, X notified the parties who obtained his subscription that he wishes to withdraw from the enterprise. The corporation, upon organization, sues X for the price of the ten shares. Is it entitled to judgment?
65. A statute requires that ten per cent. of the value of stock subscribed for in a projected corporation must be paid in cash. X subscribed for fifty shares worth $100 par. X gave his note for $500. Is his subscription binding. If so, why? If not, why not?
66. X agrees to take ten shares of stock in a corporation to be formed to conduct a department store. When X is sued for the amount of his subscription, he defends upon the ground that the company has been imperfectly organized. Is his defense good, and if it is, why is it good?
67. Discuss the failure to obtain subscriptions for the total amount of capital stock upon the liability of a subscriber.

68-69. What rules of law govern conditional subscriptions to shares of corporate stock?

70. X subscribed to ten shares of stock in a corporation to be formed to operate a linen factory with a secret agreement that he was to be released from all obligation upon his subscription at any time within one year, if he so desired. Discuss fully the legal status of this agreement.

71. Does a subscription for stock in a corporation imply a promise to pay for it?

72. Has a corporation power to release a stockholder from payment of his stock subscription where all the shareholders are willing that this be permitted? Suppose one stockholder objects; is your answer the same?

73-74. A subscribed to stock in a corporation to carry on the lumber business with a capital stock of $5,000. The corporation, as organized ultimately, is to carry on the lumber and furniture business with a capital stock of $50,000. Is A liable to the corporation upon his subscription?

75. X subscribed to ten shares of stock in a corporation to carry on the butcher business. The directors decide to run a moving picture show as well. Does this release X from his obligation? Give reasons.

76. A corporation is chartered to build a railroad from Kalamazoo to Oshkosh. After organization, the legislature, which had reserved the right to amend or alter the corporate charter, changes the route so as to make Weehawken the terminus instead of Oshkosh. The corporation accepts the amendment. R, a subscriber to five hundred shares of stock, consistently objected, and now contends that he is released from liability upon his stock subscription. Is R right? If so, why?

77. Discuss the manner in which fraud or mistake may affect subscriptions to capital stock.

78. What do you understand to be the functions of an underwriter of corporate stock?

79. In what manner does the state retain control over corporations?

80. What is meant by the right of visitation?

81. What five methods may the courts use to control corporations?
82. In what ways can the legislature restrain corporations?
83. How does the power of eminent domain affect corporations?
84. A corporation is chartered by the state of X to operate a public lottery. May its charter lawfully be taken away?
85. What are the chief elements of corporate taxation?
86. What do you understand by a franchise tax?
87. May corporate property be taxed?
88. State X imposes a tax upon the capital stock of the Y corporation. Subsequently it enacts a statute taxing the shares of stock in the hands of their individual owners. The shareholders resist the collection of this second tax. Is their resistance successful? Give reasons.
89. Discuss the power of repeal and forfeiture of charters.
90. X, Y and Z apply to the legislature of the province of Ontario for a charter to incorporate as a wholesale groceries company. The charter is granted. Is this transaction a contract?
91. State the facts and the decision in the famous case of Dartmouth College v. Woodward.
92. Discuss the effect of the decision in the Dartmouth College Case.
93. Discuss the reserved power to amend or alter a corporate charter.
94. The state of X grants a franchise to A, B and C to act as a state bank. The banking corporation becomes insolvent and makes a general assignment of all its property and assets for the benefit of its creditors. The assignee petitions the court for leave to sell the corporate franchise. Should the court grant the petition?
95. What common law rules are applicable to corporate trusts and monopolies?
96. What was the rule laid down in the Standard Oil and Tobacco Trust decisions?
97. What are the two general theories of corporate capacity?
98. How should a corporate charter be construed?
99-100. A corporation is organized to conduct a hotel business in a country town. May it lawfully do the follow-

ing: (a) Run a barber shop? (b) Run a line of taxicabs for the accommodation of guests? (c) Purchase and hire out automobiles to patrons? (d) Build and operate a swimming pool to which an admission fee is charged, and to which all are welcome?

101. A corporation enters into a contract without the use of its corporate seal. When sued thereon it contends that the contract is not binding. Is this argument a valid one?
102. X corporation, needing money, borrows $5,000 from a banking firm, giving its promissory note. When sued on the note it argues that it is without power to issue promissory notes. Does this defense prevail?
103. Has a corporation power to make or endorse accommodation paper?
104. A corporation is organized to exist for a term of ninety-nine years. Can it take and hold a fee-simple in real estate?
105. X corporation is losing money and is on the brink of insolvency. By a vote of 284 to 276 the stockholders decide to sell out the entire corporate property and wind up the business. Discuss the validity of this transaction.
106. Has a corporation power to pledge or mortgage its property, and are all corporations treated alike in this regard?
107. A brewery company guarantees to a hotel company the payment of rent by M, a saloon keeper, who purchases beer from the brewing company and who is in business relations with it. The hotel company is not paid for two months and seeks to hold the brewing company on its guaranty. Can it do so?
108. A corporation is organized with power, among other things, to act as trustee. Is this valid?
109. Discuss the power of a corporation to make by-laws.
110. Has a private corporation the right to make an assignment for the benefit of its creditors?
111. Discuss the development of the right of a corporation to take property by bequest or devise.
112. Action to recover damages from the X corporation for refusing to purchase at par certain shares of its own stock from the plaintiff. The X corporation had decided to form a pension fund for the benefit of its employees

and to invest a portion of its surplus in its own stock to be held for the benefit of the employees. Is plaintiff entitled to judgment?

113-114. Is a holding-company legal? If so, give reasons.

115-116. The New York City Railway Co. and the Brooklyn Rapid Transit Co., two corporations, enter into a partnership agreement. They do business as partners for a term of one year. At the end of that time the Brooklyn Rapid Transit Co. repudiates the partnership agreement (which was to last for ten years), and also refuses to account for the earnings and profits during the past year. What are the rights of the New York City Railway Co.?

117. Discuss the right of a railroad company to purchase and operate a system of ferry boats in connection with its railroad line.

118. A, B and C, incorporated as the "Grand Universal Collection Company," contend that they have the right to practice law in the name of the company. Have they this right?

119. May a glass manufacturing corporation purchase glassware from X in order to fill its orders while its factory is being rebuilt and enlarged after a fire?

120. What is the modern tendency in construing corporate powers?

121. Define the term ultra vires.

122. Distinguish ultra vires acts from illegal acts.

123. Trace briefly the development of the ultra vires doctrine.

124. John Doe deeds ten acres of land to the Y. M. C. A. of Urbana, Illinois. Assume that under the law of Illinois such corporations may not hold any real estate. John Doe becomes repentant of his generosity and sues to recover the real estate and to have the conveyance declared void. The Y. M. C. A. defends. Who wins and why?

125-126. Bill in equity brought by the heirs in law of X to restrain the executors of X from paying over, and Cook College from receiving a devise to said college contained in the last will and testament of X. A section of the college charter provided that it "may take and hold by purchase, gift, devise or bequest, personal and real estate

in all not exceeding one million dollars, in value, owned at any one time." The college had, at the time of testator's death property to the full amount of one million dollars in value. The executors and the college met the bill with demurrers. What decision and why?

127. Discuss ultra vires transfers of property by the ordinary private corporation.

128. A corporation organized to carry on a groceries business enters into a contract whereby it agrees to purchase a banking business from X. X is ready and willing to carry out, but the corporation repudiates the contract. X sues for damages for breach of contract. The corporation demurs. Should its demurrer be sustained or overruled?

129. X conveys 50 acres of agricultural land to the State Bank of Lanesville and receives the purchase price therefor. Subsequently, the land rising in value, X insists that the corporation was without power to take and hold the real estate, and brings a bill in equity to rescind the conveyance. Who wins and why?

130-134. A corporation, organized to manufacture iron, orders and receives 5,000 yards of silk from X. X sues to recover the agreed purchase price of $2 per yard. Can X recover the contract price, and are the authorities in harmony? Discuss fully.

135. Discuss the right of rescission of an ultra vires contract.

136. What are the modern tendencies in regard to ultra vires corporate transactions?

137. What doctrine prevailed at common law as to the liability of a corporation for its crimes and torts?

138-139. The selling agent of a corporation fraudulently misrepresents the quality of its goods. Is the corporation liable to the defrauded vendee in an action of deceit?

140. A newspaper maliciously publishes an untrue story about an attorney to the effect that he had swindled certain helpless orphans in his administration of a trust estate. Is the corporation, which publishes the newspaper, liable?

141. Can a corporation be compelled to pay punitive damages?

142. A corporation unlawfully employs its help ten to twelve hours a day, though forbidden by statute to work them

for more than eight hours a day. Is it subject to indictment?

143-144. Can a corporation be held criminally liable for knowingly and wilfully sending obscene literature through the mails?

145. What is the modern tendency in regard to holding corporations amenable to the criminal law?

146. Define directors.

147. What relation exists between a private corporation and its directors?

148. Have the directors of a corporation power to increase the amount of its capital stock?

149. The directors of a private corporation refused to obey the wishes of the majority of the stockholders. Are they within their rights in so acting?

150. A, B and C are the directors of a corporation. All are present at a dance. A comes up to B and asks whether B is in favor of buying certain property for the corporation. Says B: "Yes, I am." A says: "So am I." A then asks C, who says that he is not in favor of it. The property is purchased. Discuss the validity of the transaction.

151. Has the Board of Directors of a corporation the power to delegate its authority to an executive committee consisting of the chairman of the board and two other directors?

152. How, if at all, may a director who is unlawfully removed from office obtain redress?

153. X acts as director of a corporation for a term of three years, and performs very valuable services. Subsequently X sues to recover from the corporation the sum of $5,000, which he claims is the reasonable value of his services. The corporation concedes this, but insists that it is not liable. Is it right or wrong and why?

154-155. Directors, honestly believing that it is within the scope of their powers, subscribe $5,000 in cash out of the corporate funds for the relief of the sufferers in the recent floods in the Mississippi Valley. To what extent may they be held personally liable?

156-158. The directors of a savings bank in Chicago enter

upon an elaborate street car advertising campaign, construct a new and magnificent building, and purchase very expensive furnishings, honestly acting, as they believe, for the welfare of the institution. The bank, already a weak concern, is greatly weakened and ultimately insolvency ensues. The receiver sues the directors to recover the losses caused by their alleged misconduct. The directors demur. What decision and why?

159-160. The directors of a corporation at the end of a very successful year's business, voted to one of their number, who acted also as president of the company, in grateful recognition of his services, a large bonus in addition to the salary provided for in his contract with the company. The president did not participate in the meeting at which the bonus was voted. Have the stockholders a right to recover this bonus from the president or from the directors?

161. X, Y and Z, the directors of a corporation, were presented by the ABC Company with the sum of $5,000 each in return for their services in procuring a contract for the ABC Company with the corporation of which they were directors. This became known to the stockholders, who sought to hold the directors for the sums so received. Can they do so, and if so, on what theory?

162. Discuss the validity of contracts entered into between corporations with interlocking directorates.

163-164. X, a director in the A corporation, approached R, a stockholder therein, and offered R $85 per share for his stock. The market price was then only $84 per share. X, however, by virtue of his official position, possessed certain information which he knew would cause the stock soon to soar in value. The information which he had, X did not disclose to R. Subsequently the stock was sold, pursuant to this offer, by R to X. When the stock rose in price, R sought a recission of the transaction. May R obtain relief, and if so, on what principle?

165. What are the powers respectively of the chief officers in the ordinary private corporation?

166. Outline the doctrine of de facto corporate officers.

167. Explain the necessity of members in a corporation.

168. How is membership acquired in a stock and a non-stock corporation respectively?
169. What is a one-man company?
170. Explain what is meant by the term quorum.
171. Distinguish between the capital stock of a corporation and its capital.
172. What is the distinction between capital stock and shares of stock?
173. Explain the nature of a share of corporate stock.
174. What do you understand to be the rights of a holder of 5 per cent non-cumulative preferred stock?
175. How may shares of stock in a corporation be transferred?
176. A by-law is enacted by a corporation providing that shares of stock must be offered to the corporation for sale before being sold to any outside party, the corporation being given the first option of purchase at the fixed price. Is this valid or is it an unlawful restraint upon the free transfer of personal property?
177. What are the effects of an executed transfer of stock?
178. What two theories exist as to the effect of registration of transfer of shares of stock on the corporate transfer books?
179. What are the rights of attaching creditors against shares of stock which have been transferred in good faith by the debtor to X, but which have not been transferred to the name of X upon the corporate records?
180. Discuss the effect of a transfer made upon a forged power of attorney.
181. X entrusts his certificate for ten shares of railroad stock to Y, as security for a loan by Y to X. Y fraudulently sells the certificate, which X had endorsed in blank, to Z. Z pays full value and acts in absolute good faith. What are the rights of Z?
182. To what extent, if at all, is a certificate of stock a negotiable instrument?
183. How can M, who has purchased 5,000 shares of stock in a railroad company, in order to obtain control, compel the corporation to recognize him as the owner and accord him the privileges of such?

184. What are the rights of the stockholders as to the performance of extraordinary corporate acts, such as a stock increase?
185. A pledges ten shares of stock which he owns to B. Who can vote these shares at a meeting of stockholders?
186. X, a shareholder in the United States Steel Corporation, is ill and unable to attend the annual meeting of stockholders. How can he cast his vote?
187. Discuss the validity of a voting trust.
188. What do you understand by cumulative voting?
189. The directors of a corporation decide that the by-laws are cumbersome. Accordingly, they proceed to change them without calling a meeting of the stockholders. Are the by-laws adopted in this manner valid?
190. Corporation Y declares a dividend for the year 1912, though it has made no profits during the year. Discuss the validity of the dividend so declared.
191. What is meant by a stock dividend?
192. A corporation engaged in the business of iron manufacturing, in which X was a stockholder, accumulated a surplus of $500,000 on a capital stock of $1,111,000. What remedy, if any, has the stockholder to compel the declaration of a dividend?
193. On the 16th day of April, 1912, the directors of a corporation declared a dividend of 6 per cent. payable on May 1st to stockholders of record on April 30th. On the 21st day of April, A, a registered holder of 1,000 shares of its stock, transferred them to B by delivering to B a stock certificate duly endorsed. Who is entitled to the dividend?
194. Discuss the right to dividends as between a tenant for life and a remainderman.
195. The directors of a corporation, on May 1st, 1913, declared an annual dividend of 3 per cent. The sum of $25,000 in cash was set aside from the corporate funds in order to pay the dividend. On July 15th, 1913, the corporation became bankrupt. What is the right of Y, a holder of ten shares of stock, to his dividend in competition with the general creditors of the corporation?
196. A corporation decides to increase its capital stock from

$100,000 to $200,000. You own fifty shares of stock in the company. What are your rights with regard to the new issue?

197. Suppose, in the preceding question, the original authorized capital stock was $200,000. Would your answer be the same?

198-199. X, the owner of ten shares of stock in the New York City Railway Co., suspects that there has been reckless extravagance in its management. Is he entitled to an examination of the corporate books and accounts by a firm of expert accountants selected by him, and if so, why?

200. A statute confers upon a stockholder the right to an inspection of the books, papers, and records of a corporation in which he owns shares. X purchases ten shares of stock in the Y corporation in order to discover certain wrongdoing on the part of the corporation, which he suspects. X demands an inspection of the corporate books. The corporation, insisting that the motive of X is hostile and improper, refuses. X petitions for a writ of mandamus. Is X entitled thereto?

201-202. You are a shareholder in the Johnson Manufacturing Co., which proposes to subscribe the sum of ten thousand dollars in order to erect a monument to the memory of Hannibal. You are uninterested in Hannibal and voted in the negative. What rights, if any, have you, and how would you protect them?

203-205. The directors of corporation X, authorized by its charter to manufacture all kinds of vehicles drawn by horses, unanimously decided to enter upon the manufacture of automobiles, and for that purpose to sell out all its plant and to purchase land and to build and equip a building suitable for the manufacture of automobiles. This decision of the directors was not submitted to the stockholders for their approval. What are the rights of A, a stockholder, after action has been taken and much loss has resulted; and how should A enforce his right, if any?

206. X and Y, two shareholders in a corporation, acquiesce in the commission of a breach of trust by the directors

whereby the corporation loses much money. Several stockholders had objected. Subsequently, Y sells his stock to A, who is ignorant of the breach of trust. X consults you to ascertain whether he can maintain an action to compel the directors to make good the loss, and if so, what kind of action he can bring. A also consults you, asking similar questions. Give your opinion in reply to each.

207. State the essentials of the new Federal Equity Rule governing the bringing of stockholders' bills.

208. Enumerate at least two defenses to an action brought by a stockholder on behalf of a corporation.

209-210. Discuss briefly the powers of the majority stockholders in a private corporation.

211. X has sold 5,000 yards of silk to the Y corporation at $2 per yard and is, therefore, its creditor for $10,000. X thinks that a certain contract which the corporation is about to make is foolish and improvident. May X enjoin the corporation from entering into this contract?

212. What do you understand is meant by the "Trust Fund Doctrine"?

213. What is the attitude of the recent decisions towards the "Trust Fund Doctrine"?

214. The Y corporation, having become insolvent, secures to D one of its directors, a preference over other creditors. No local statute forbade the giving of a preference. The claim of D against the corporation was an honest one. What are the rights of D?

215. Discuss the statutory liability of a corporate director.

216. Does a trust relation exist between a creditor and a stockholder?

217-219. A corporation issues part of its stock to X, under a written contract that X shall be liable to pay only 50 per cent. of the par value. The corporation subsequently becomes insolvent. Creditors, who loaned money to it, some before and some after the above stock issue, now seek to compel X to pay the balance of the par value of his shares of stock. Do they win? Do any of them win? Give reasons.

220. Distinguish the "good faith" rule from the "true value" rule where stock is issued by a corporation for property.
221. What do you understand by "watered stock"?
222. X deals with a corporation with full knowledge that its stock was watered. The corporation becomes insolvent. What are the rights of X as against the holders of watered stock?
223. Discuss the statutory liability of stockholders to creditors.
224. X, a shareholder in a national bank, with full knowledge that the bank is insolvent, transfers his stock therein to Y, who is financially irresponsible. X does so because he wishes to evade the double liability of a stockholder in a national bank. The receiver sues X. Who wins and why?
225. What are the methods of dissolution of a private corporation?
226. The Williams Hotel Co. transfers a hotel and fixtures, its only assets, to Z. Does this work a dissolution of the company?
227. A corporate charter provided that corporate existence should cease if the entire capital stock was not paid in within two years from the time of organization. At the end of two years one-fifth of the capital stock was still unpaid. Was there a corporation in existence on the day after the two years expired?
228. Will the commission of any ultra vires act induce a court to render a judgment of forfeiture of a charter?
229. Has equity any jurisdiction, in the absence of statute, to decree the dissolution of a private corporation?
230-232. Discuss the effect of corporate dissolution upon the personal and real property, the debts and the litigations, of a private corporation, at common law and under modern statutes.
233. What is the status of national corporations in a state?
234. The Whitney Manufacturing Co., incorporated under the laws of Arizona, desires to do business in Montana. The latter state arbitrarily refuses to permit it to transact business there, assigning no reason. What are the rights of the Whitney Co.?

235. Explain what you understand the rule of comity to mean.
236. Briefly describe the different methods adopted by the several states to regulate and restrict the methods of doing business by foreign corporations within their boundaries.
237. Is the business of insurance considered as "commerce" within the interstate commerce clause of the Federal Constitution?

QUIZ QUESTIONS

LAW OF PARTNERSHIP

(*The numbers refer to the numbered sections in the text.*)

1. State the sources from which our law of partnership has been drawn.
2. State the confusion to which this development has given rise.
3. What three theories are there as to partnerships?
4. Define partnership.
5. What does the conception of association mean as applied to partnership?
6. Distinguish true partnership from partnership by estoppel.
7. Define partnership as to third parties.
8. State the exceptions to the profit-sharing test.
9. (a) Does this profit-sharing test still exist in England?
   (b) Does it exist in the American states?
10. Why is mutual agency no test of partnership?
11. Why is common ownership no test of partnership?
12. What is the true test of partnership?
13. Distinguish between legal and actual intent to form a partnership.
14. What will be taken into consideration by the courts in ascertaining the intention to form a partnership?
15. State the tests by which an intention to become partners is ascertained in doubtful cases.
16. Which relations bear the closest analogy to partnership?
17. Distinguish corporations from partnerships.
18. Distinguish voluntary associations from partnerships.
19. Distinguish joint ownership from partnerships.
20. How does a partnership come into existence?
21. What formalities are required?

22. In how far does the Statute of Frauds have any influence in regard to a partnership contract?
23. State reasons why a partnership may be impossible between two persons though they may both have sufficient capacity to contract and though their minds have met.
24. (a) Suppose a boy 19 years old enters into a partnership. He invests some money and the partners carry on business. (b) Can the minor repudiate his agreement before he is 21? If he continues in the business for a year after he is 21 can he then repudiate it? (c) If he repudiates before he is 21, will he be allowed to withdraw the money which he has invested?
25. (a) What capacity has a lunatic to be a partner? (b) What distinction is there between an alien friend and an alien enemy in this regard?
26. (a) State the common law rule as to the right of a married woman to enter into a partnership. (b) What modifications has this rule undergone through modern statutes?
27. What power has a corporation to be a partner?
28. Suppose A agrees with B to take him into partnership. B obligates himself to nothing at all and suffers no detriment and confers no benefit on A. Is the contract enforcible? Why?
29. Will courts recognize a contract of partnership for the purpose of robbing or stealing? Why?
30. Distinguish between a contract of partnership and a contract to form a partnership.
31. What is meant by partnership by estoppel? Does it create a true partnership?
32. Under what circumstances will the stockholders in a defectively organized corporation be held liable as partners?
33. What restrictions, if any, exist in the choice of a firm name?
34. What distinction exists as to the use of the firm name in transactions involving real estate and transactions involving personal estate?
35. Define good will.
36. Under what circumstances will property be considered as firm property as distinguished from the individual property of the partners?

37. (a) What property may be treated as firm capital? (b) Are labor or services so considered?
38. What is the nature of a partner's interest in firm property?
39. (a) What distinction is there between real and personal property? (b) Under what circumstances will equity treat real estate as personal property?
40. State the two rules in force in America as to when dower in partnership property attaches.
41. What is required to transfer (a) partnership real estate; (b) partnership personal property to one of the members of the partnership?
42. What power has one of the partners to transfer firm property?
43. What two views are adopted by the courts as to the interests acquired by simultaneous or successive independent transfers of the interests of partners in the partnership property?
44. (a) In whom will the title to personal firm property vest on the death of a partner? (b) Who takes the title to real estate (1) in America? (2) in England?
45. What are the duties of a surviving partner in relation to firm property?
46. Suppose A and B are partners. They agree that on the death of either, C is to be admitted into the partnership. Is this agreement binding on A and B? Is it binding on C?
47. (a) Define joint liability; (b) several liability; (c) joint and several liability.
48. What does the estate of a deceased partner become liable in equity for the joint debts of the partnership? State the two rules.
49. (a) For how much of the firm debts is any one partner liable? (b) How can he restrict his liability?
50. Can persons who have not as yet become partners bind each other to a partnership liability? Why?
51. State the various ways by which a new partner may become liable for the debts of the firm created before he became a member of it.
52. What is the liability of a partner for firm debts after he has withdrawn from the firm?

53. State the various means by which a joint liability may be discharged.
54. In which cases of dissolution must notice of the dissolution be given?
55. (a) Who is a former dealer? (b) What notice must be given to him? (c) What notice is necessary as to others?
56. What is the nature and extent of liability of a partnership in tort as distinguished from liability in contract?
57. What powers have partners among themselves? (a) Where they have made an agreement in this regard? (b) In the absence of an agreement?
58. What is meant by the apparent authority of a partner?
59. What is taken into consideration in testing a partner's implied powers?
60. Why is a distinction made between a professional and a trading partnership?
61. Define ratification and estoppel.
62. What power has a commercial partnership to borrow money?
63. What kinds of partnerships have implied power to execute commercial paper?
64. What is the power of partners in regard to sealed instruments?
65. (a) Has a partner implied power to assign for the benefit of creditors? (b) If not, what express direction will be regarded as sufficient?
66. What are the limits of a partner's power to subject the partnership to a tort liability?
67. What powers do the partners have after a dissolution of the partnership?
68. By what are the duties of partners toward each other regulated (a) where there is an express partnership agreement; (b) in the absence of such an agreement?
69. (a) What duty of good faith does one partner owe to the other? (b) How far does this duty extend? (c) Does it cover persons who are negotiating for a partnership?
70. Suppose A and B are in business as bankers. A in good faith, through an error of judgment, makes a bad investment. Is he liable to B for the loss thus caused?
71. (a) State the powers and duties of a majority of the part-

ners in a firm. (b) What limitations are there as to these powers?

72. What are the rights of the individual partners to participate in the management of the firm business (a) where their agreement touches on this matter? (b) where it is silent on the same?
73. What right has a partner to inspect the firm books?
74. What is the right of a partner in a firm to carry on a separate business?
75. (a) What do you understand by contribution? (b) How does this principle work out as applied to partnerships?
76. What are the rights to compensation of a partner for extra services in the absence of an agreement as to this matter?
77. Define what is meant by a partner's lien?
78. State how the assets of a partnership are disposed of on a dissolution of the firm.
79. By what means and against what property can a judgment creditor of a partnership satisfy his judgment?
80. Under what circumstances can a creditor of a partnership attach the property of the firm?
81. Suppose A, a partner in the firm of A and B, is indebted to C, and the debt has been converted into judgment. C levies execution on the interest of A in the partnership property. The partnership is indebted to other persons. What must C do to realize on the execution?
82. Can an individual creditor of a partner garnishee a debtor of the partnership where the debt owed is (a) in the shape of money; (b) in the shape of other tangible property?
83. In what ways does equity acquire jurisdiction in partnership affairs?
84. State the rule as to priority of firm creditors over separate creditors in regard to firm property.
85. Under what circumstances will a partner be estopped to deny that his separate property is firm property?
86. State the rule of priority of a separate creditor's claim as against separate property.
87. What exception to the rule of the priority of separate creditors as against separate estate are recognized?
88. What are the remedies of secured creditors, (a) where

the estate is in bankruptcy; (b) where it comes into court in some other way?

89. State separately (a) the English, (b) the American rule as to the right of joint and several creditors to file claims against the separate and the firm estates.
90. (a) Under which circumstances will a partner be allowed to prove a claim against his copartners' estate? (b) Why will he not be allowed to do this under all circumstances?
91. (a) Who is entitled to the possession of the firm property where one of the partners becomes bankrupt? (b) State the old and the new rule.
92. (a) Under what circumstances will the firm creditors of a deceased partner share equally with his individual creditors? (b) When will the individual creditor have a preference over the firm creditor?
93. State the origin of courts of equity.
94. What two difficulties are in the way of an action at law between partners?
95. Under what circumstances will courts of law maintain an action between partners?
96. What is the rule as to action at law between partners after final settlement?
97. (a) Will law courts maintain an action between partnerships with a common member? (b) What is the view of the equity courts in regard to such actions?
98. How does the code system of pleading affect partnership actions?
99. (a) By what principle in regard to the legal remedy is equity guided in entertaining or rejecting a suit? (b) State some situations in which equity will refuse to interfere.
100. What is the rule in equity where an account is sought upon dissolution?
101. Under what circumstances will equity grant an accounting without dissolution?
102. For what purposes will equity decree a specific performance of a partnership contract?
103. (a) Define an injunction. (b) Will this remedy be applied to a partnership controversy?
104. Under what circumstances will a receiver be appointed?

105. (a) Who must be joined as plaintiffs in an action by a firm? (b) What exceptions are there to this rule?
106. Who must be joined as plaintiff where a contract for a firm has been made in the name of an individual partner?
107. Who must sue in an action by the firm for a tort?
108. (a) State the general rule as to parties defendant where partners are sued. (b) State its exceptions?
109. Who must be made defendants where it is sought to enforce a tort liability against partners?
110. Who must be made defendants where the firm of A and B contract an obligation and thereafter, but before suit is brought against them, take C into partnership?
111. What is the effect of the retirement of a partner on the right of a creditor to bring suit?
112. What effect has the death of a member of a debtor firm on the parties defendant where (a) the contract is joint; or where (b) it is joint and several?
113. What effect has the bankruptcy of a partner on the parties (a) where the firm attempts to enforce an obligation; (b) where it is sought to enforce an obligation against the firm?
114. What difficulty is there in the way of a suit where one partner is disqualified to sue?
115. What is the effect of statutes which allow actions to be brought in the partnership name?
116. State the various ways in which partnerships may be dissolved.
117. What is meant by termination by operation of law?
118. What effect has the death of a partner on the partnership?
119. What effect has the bankruptcy of a partner on the partnership?
120. What is the effect on a partnership if one of the partners disposes of all his interest in the firm?
121. What effect has the marriage of a female partner on the firm (a) at common law; (b) under modern statutes?
123. State how a partnership may be dissolved by mutual agreement.
124. Under what circumstances may a firm be dissolved by the act of fewer than all the partners?

125. Under what circumstances will a partnership be dissolved by judgment?
126. State the forms of partnership in which there is no unlimited liability or no close personal relationship?
127. (a) Define a limited partnership. (b) What is its origin?
128. What formalities must generally be followed in creating a limited partnership?
129. How does a limited partnership terminate?
130. What are the duties and liabilities of limited partners?
131. What is the origin of joint stock companies?
132. State the characteristics of mining partnerships.
133. Define the different kinds of partners.

QUIZ QUESTIONS

LAW OF BANKS, BANKING AND TRUST COMPANIES

(*The numbers refer to the numbered sections in the text.*)

1. What is the general purpose of banking?
2. (a) Define "bank," "banking," "trust company," "national banks," "savings banks," "private banks," "clearing house." (b) What classes of banks and bankers are indicated by § 3407, Revised Statutes of the United States?
3. What determines the powers of incorporated banks?
4. What constitutes the charter of a bank?
5. What are the powers and disabilities of national banks?
6. (a) State the general rule as to the liability of banks for tort? (b) How is it affected by the fact that the bank is incorporated? (c) State some of the torts for which a bank is liable.
7. Name the classes of bank deposits.
8. (a) What is a check? (b) What are its chief characteristics?
9. What are the necessary contents of a check?
10. (a) What is the duty of the holder of a check as to its transfer or presentation for payment? (b) When is presentment not necessary?
11. (a) What is the nature of the action for damages for dishonor of a check? (b) What is the rule stated as to presumption of substantial injury?
12. (a) What constitutes certification of a check? (b) What is the effect of certification?
13. (a) What is the reason for the right of the drawer of a check to stop payment? (b) How is that right affected by the certification of the check?

14. (a) What is the nature and extent of a bank's liability for loss or damage from the default of its agents in making a collection? (b) Is a bank liable for the failure of a notary employed by it to present and protest commercial paper?
15. (a) What are the function and powers of a clearing house? (b) What effect have its rules or customs as between its constituent banks and their depositors?
16. (a) Define "forgery." (b) What limitations exist upon the liability of the bank to its depositor for the payment of a forged check? (c) May the depositor whose signature has been forged adopt the false signature as his own, and why?
17. (a) How are the charters of trust companies to be construed? (b) Are statutes authorizing trust companies to act in a fiduciary capacity without giving bond valid?
18. (a) What degree of care is required of a bank as to the custody of collateral securities? (b) If a bank is not authorized by its charter to receive bonds on special deposit, can previous deposits of the same kind be shown to fix its liability?

QUIZ QUESTIONS

LAW OF RECEIVERS

(*The numbers refer to the numbered sections in the text.*)

1. What is meant by receivers?
2. What court has jurisdiction to appoint receivers? Under what circumstances will it appoint receivers?
3. To secure an appointment what must be shown? When will receivers be appointed for partnerships and corporations?
4. What rules govern as to notice of application?
5. Who may be appointed receivers? What is required of one to be appointed? How long does he serve?
6. What rights has a receiver to trust property?
7. What power has he regarding liens?
8. To what extent may he control the property?
9. What are receivers' certificates? When issued?
10. Enumerate the order of priorities of liens against the trust property.
11. How are claims against the trust determined?
12. When may a receiver sue?
13. When may he be sued? What is his liability?
14. Discuss judgments against receivers.
15. When may a receiver sell trust property?
16. What is a receiver's duty as to accounting?
17. To what compensation is a receiver entitled?
18. What powers have foreign receivers?
19. What is an ancillary receiver? What are his powers?

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LEADING ILLUSTRATIVE CASES LAW OF PRIVATE CORPORATIONS

CHAPTER I.

THE LEGAL CONCEPTION OF A CORPORATION.

Corporation Distinguished from Its Shareholders.

QUEEN v. ARNAUD.

9 Queen's Bench 806 (Eng.). 1846.

Mandamus, directed to Elias Arnaud, collector, and Thomas Powell, controller of the customs, in and for the port of Liverpool.

LORD DENMAN, C. J.—The object of the present mandamus is to compel the custom house officers to register a vessel, the property of The Pacific Steam Navigation Company.

The company is a corporation, by charter of her present majesty, for the purpose of providing vessels and employing them in the Pacific ocean.

It is admitted by the defendants that the company, as a British corporation, might be owners of British built vessels, and prima facie would be, as such corporation, entitled to register them under the provisions of stat. 8 & 9 Vict. c. 89, applicable to the registry of vessels by corporations. But it is said that some of the members of the corporation are not British subjects, but foreigners, and, consequently, that the vessel does not wholly belong to her majesty's subjects, as required by the fifth section of the act, and is within the prohibition, contained in the twelfth section of the act, against foreigners being entitled to be owners, in whole or in part, directly or indirectly, of any vessel requiring to be registered.

Now it appears to us, that the British corporation is, as such, the sole owner of the ship, and a British subject within

the meaning of the fifth section, as far as such a term can be applicable to a corporation, notwithstanding some foreigners may individually have shares in the company, and that such individual members of the corporation are not entitled, in whole or in part, directly or indirectly, to be owners of the vessel.

The individual members of the corporation, no doubt, are interested, in one sense, in the property of the corporation, as they may derive individual benefit from its increase, or loss from its destruction; but in no legal sense are the individual members the owners. If all the individuals of the corporation were duly qualified British subjects, they could not register the vessel in their individual names as owners, but must register it as belonging wholly to the corporation as owner.

The terms of the 23rd section, with respect to the condition of the bond to be given upon obtaining the registry, as to foreigners purchasing or becoming entitled to any part or share of, or interest in, any ship or vessel, would appear to be applicable to a case of purchase or transfer of property in the vessel itself, as it provides that the certificate shall be delivered up "within seven days after such purchase or transfer of property in such ship," and does not, as it seems to us, bear materially on the present question.

It was contended that the effect might be to defeat the object and policy of the navigation laws in this respect. The individual members of the British corporation might, either originally or by transfer, be all foreigners. Such does not appear to be contemplated or provided for by the act in question. If it be *casus omissus,* and evil consequences arise, they may be remedied by the interference of the legislature, or possibly, though I do not wish to be understood as giving any opinion upon this point, by repealing the letters patent as improvidently giving powers operating to defeat the law and public policy; and, in future patents, providing against the objection; but, as the case stands, it seems to us that the British corporation is to all intents the legal owner of the vessel, and entitled to the registry, and that we cannot notice any disqualification of an individual member which might disable him, if owner, from registering the vessel in his own name.

And there will therefore be judgment for the prosecutors, and a peremptory mandamus.

Patteson, Coleridge and Wightman, Js., concurred.

Judgment accordingly.

Counsel then agreed that the registration should take place without a peremptory mandamus.

BUTTON v. HOFFMAN.

61 Wis. 20, 20 N. W. 667. 1884.

Appeal from the Circuit Court for Jackson County.

Replevin. The facts sufficiently appear from the opinion. The defendant appealed from a judgment in favor of the plaintiff.

ORTON, J.—This is an action of replevin in which the title of the plaintiff to the property was put in issue by the answer.

In his instructions to the jury the learned judge of the circuit court said: "I think the testimony is that the plaintiff had the title to the property." The evidence of the plaintiff's title was that the property belonged to a corporation known as "The Hayden & Smith Manufacturing Company," and that he purchased and became the sole owner of all of the capital stock of said corporation. As the plaintiff in his testimony expressed it, "I bought all the stock. I own all the stock now. I became the absolute owner of the mill. It belonged at that time to the company, and I am the company." There was no other evidence of the condition of the corporation at the time. Is this sufficient evidence of the plaintiff's title? We think not. The learned counsel of the respondent in his brief says: "The property had formerly belonged to the Hayden & Smith Manufacturing Company, but the respondent had purchased and become the owner of all the stock of the company, and thus became its sole owner."

From the very nature of a private corporation, or, indeed, of any corporation, the stockholders are not the private and joint owners of its property. The corporation is the real, though artificial, person substituted for the natural persons who procured its creation and have pecuniary interests in it, in which all its property is vested, and by which it is con-

trolled, managed and disposed of. It must purchase, hold, grant, sell and convey the corporate property, and do business, sue and be sued, plead and be impleaded, for corporate purposes, by its corporate name. The corporation must do its business in a certain way, and by its regularly appointed officers and agents, whose acts are those of the corporation only as they are within the powers and purposes of the corporation. In an ordinary co-partnership the members of it act as natural persons and as agents for each other, and with unlimited liability. But not so with a corporation; its members, as natural persons, are merged in the corporate identity. Ang. & A. on Corp., secs. 40, 46, 100, 591, 595. A share of the capital stock of a corporation is defined to be a right to partake, according to the amount subscribed, of the surplus profits obtained from the use and disposal of the capital stock of the company to those purposes for which the company is constituted. Id., sec. 557. The corporation is the trustee for the management of the property, and the stockholders are the mere cestuis que trust. Gray v. Portland Bank, 3 Mass. 365; Eidman v. Bowman, 4 Am. Corp. Cas. 350. The right of alienation or assignment of the property is in the corporation alone, and this right is not affected by making the stockholders individually liable for the corporate debts. Ang. & A. on Corp., sec. 191; Pope v. Brandon, 2 Stewart (Ala.) 401; Whitwell v. Warner, 20 Vt. 444. The property of the corporation is the mere instrument whereby the stock is made to produce the profits, which are the dividends to be declared from time to time by corporate authority for the benefit of the stockholders, while the property itself, which produces them, continues to belong to the corporation. Bradley v. Holdsworth, 3 Mees. & W. 422; Waltham Bank v. Waltham, 10 Met. 334; Tippets v. Walker, 4 Mass. 595. The corporation holds its property only for the purposes for which it was permitted to acquire it, and even the corporation cannot divert it from such use, and a shareholder has no legal right to it, or the profits arising therefrom, until a lawful division is made by the directors or other proper officers of the corporation, or by judicial determination. Ang. & A. on Corp., secs. 160, 190, 557; Hyatt v. Allen, 4 Am. Corp. Cas. 624. A conveyance of all the capital stock to a purchaser gives to such purchaser only an equitable interest in the prop-

erty to carry on business under the act of incorporation and in the corporate name, and the corporation is still the legal owner of the same. Wilde v. Jenkins, 4 Paige 481. A legal distribution of the property after a dissolution of the corporation and settlement of its affairs, is the inception of any title of a stockholder to it, although he be the *sole* stockholder. Ang. & A. on Corp., sec. 779a.

These general principles sufficiently establish the doctrine that the owner of all the capital stock of a corporation does not therefore own its property, or any of it, and does not himself become the corporation, as a natural person, to own its property and do its business in his own name. While the corporation exists he is a mere stockholder of it, and nothing else. The consequences of a violation of these principles would be that the stockholders would be the private and joint owners of the corporate property, and they could assume the powers of the corporation, and supersede its functions in its use and disposition for their own benefit without personal liability, and thus destroy the corporation, terminate its business, and defraud its creditors. The stockholders would be the owners of the property, and, at the same time, it would belong to the corporation. One stockholder owning the whole capital stock, could, of course, do what several stockholders could lawfully do. It is said in Utica v. Churchill, 33 N. Y. 161, "the interests of a stockholder is of a collateral nature, and is not the interest of an owner;" and in Hyatt v. Allen, supra, that "a shareholder in a corporation has no legal title to its property or profits until a division is made." In Winona & St. P. R. R. Co. v. St. P. & S. C. R. R. Co., 23 Minn. 359, it is held that the corporation is still the absolute owner, and vested with the legal title of the property, and the real party in interest, although another party has become the owner of the sole beneficial interest in its rights, property and immunities. In Baldwin v. Canfield, 26 Minn. 43, it was held that the sole owner of the stock did not own the land of the corporation so as to convey the same. In Bartlett v. Brickett, 14 Allen 62, an action of replevin was brought by A, B, and C, as the "Trustees of the Ministerial Fund in the North Parish in Haverhill," which was the corporate name. In portions of the writ the plaintiffs were referred to as "the said trustees"

known or used by others, useful to improve quality, and diminish cost of sugar. To protect against unlawful combinations of labor. To prevent the lowering of the standard of refined sugars, and generally to promote the interests of the parties hereto in all lawful and suitable ways. Board: All parties hereto not corporations, to become such before deed goes into effect; all shares of stock of each corporation to be transferred to a board, consisting of eleven persons, any member to be removable by two-thirds of the entire board for incapacity or refusal to serve, vacancies in term to be filled by vote of board, at end of terms by election of certificate holders, at an annual meeting in New York City. Board to make by-laws for themselves, act by proxy if they choose, majority to be a quorum, and majority of quorum to control, except in appropriating money, a majority of all required; members of board to be members of boards of directors of the several companies; shares in such companies to be transferred to them in order to qualify them, if necessary; members of board to be divided into three classes, first to serve seven years (each being named), second, five years (each named), and third, three years (naming them). Officers: Board to appoint a president, vice-president and treasurer from the members of the board, and a secretary (not necessarily a member of the board), and such other officers as necessary, fixing their duties. Plans: The several parties hereto to maintain their separate organizations, and carry on and conduct their own business. Capital stock of each corporation to be transferred to the board, and certificates not exceeding $50,000,000 (500,000 shares of $100 each) to be issued by the board to each refinery in proportion to the value of its plant as fixed by appraisers to be selected, and each stockholder in each refinery to have such proportion of the certificates issued to each refinery as his stock bore to the stock of that refinery, except 15 per cent. of the shares allotted to each refinery to be left with the board to be disposed of for the purchase of other refineries or increasing the refining capacity of the parties hereto.

The certificate provided that the holder was entitled to ——— shares in the sugar refineries company, subject to the provisions of the deed, transferable on the books of the board

upon surrender, subject to right to increase the total stock, or change this deed, and the assignee, by accepting the certificate to be held to agree to the terms of the deed, or changes made therein. The title to the stock of the corporations to be in the members of the board of trustees, strictly as joint tenants and having all the rights and powers incident to stockholders in the several corporations, subject to the provisions of this deed. Profits of each corporation to be paid to the board, and dividends distributed by the board to certificate holders. Changes in the deed to be made by a majority of certificate holders. Other refineries to be added upon terms provided by the board. Custody of the deed to be in the president of the board, with sole and independent control, and not to be shown to any corporation, firm or person whatsoever except by express direction of the board.

The stockholders of the North River Sugar Refining Company in April, 1887, at a meeting when all the trustees were present, appointed a committee to make arrangements to consolidate the sugar refineries of New York, and directed the president and secretary to sign such contract as the committee should make for that purpose. The secretary, on behalf of the company, in September signed the foregoing deed to go into effect in October. In November, at a stockholders' meeting, the powers of the committee and the president and secretary were revoked, but it was recited that one John Searles, Jr., had offered to purchase all of the stock for $325,000, and it was unanimously resolved that a committee be appointed to deliver it to him, the proceeds to be divided in proportion to the ownership of shares by the stockholders. Accordingly, the members individually, transferred their shares, indorsed in blank, to Searles, who was a member and the secretary and treasurer of the board created by the deed above set forth; the stock was by Searles transferred to the board, and it issued certificates to the shareholders to the amount of $700,000, less 15 per cent., as provided by the deed; new directors were chosen by the board, Searles became president, and shortly afterward the works of the North River Sugar Refineries Company were closed, and never run thereafter, though it was allotted its share of dividends for its certificate holders.

FINCH, J.—The judgment sought against the defendant is one of corporate death. The state, which created, asks us to destroy; and the penalty invoked represents the extreme rigor of the law. Its infliction must rest upon grave cause, and be warranted by material misconduct. The life of a corporation is indeed less than that of the humblest citizen, and yet it envelopes great accumulations of property, moves and carries in large volume the business and enterprise of the people, and may not be destroyed without clear and abundant reason. That would be true, even if the legislature should debate the destruction of the corporate life by a repeal of the corporate charter; but is beyond dispute where the state summons the offender before its judicial tribunals, and submits its complaint to their judgment and review. By that process it assumes the burden of establishing the charges which it has made, and must show us warrant in the facts for the relief which it seeks. * * *

Two questions, therefore, open before us; first, has the defendant corporation exceeded or abused its powers; and second, does that excess or abuse threaten or harm the public welfare.

The first question requires us to ascertain what the defendant corporation has done in violation of its duty, or omitted to do in performance of its duty. We find disclosed by the proof that it has become an integral part and constituent element of a combination which possesses over it an absolute control, which has absorbed most of its corporate functions, and dictates the extent and manner and terms of its entire business activity. Into that combination, which drew into its control sixteen other corporations engaged in the refining of sugar, the defendant has gone, in some manner and by some process, for, as an unquestionable truth, we find it there. All its stock has been transferred to the central association of eleven individuals denominated a "Board"; in exchange it has taken and distributed to its own stockholders certificates of the board carrying a proportionate interest in what it describes as its capital stock; the new directors of the defendant corporation have been chosen by the board, made eligible by its gift of single shares, and liable to removal under the terms of their appointment at any moment of inde-

pendent action. It has lost the power to make a dividend, and is compelled to pay over its net earnings to the master whose servant it has become. Under the orders of that master it has ceased to refine sugar, and, by so much, has lessened the supply upon the market. It cannot stir unless the master approves, and yet is entitled to receive from the earnings of the other refineries, massed as profits in the treasury of the board, its proportionate share for division among its own stockholders holding the substituted certificates. In return for this advantage it has become liable to be mortgaged, not for its own corporate benefit alone, but to supply with funds the controlling board when reaching out for other and coveted refineries. No one can look these facts fairly in the face without being compelled to say that the defendant is in the combination and in to stay. Indeed, so much is with great frankness admitted on the part of the appellant. Its counsel concedes that the stock was transferred "to the board mentioned in the agreement and on the terms and for the purposes mentioned in the agreement; and that this action effectually lodged the control of the defendant company, so far as such control can be secured by the voting power, in that board."

But that truth does not alone solve the problem presented. We are yet to ascertain whether the corporation became the subordinate and servant of the board by its own voluntary action, or the will and power of others than itself; by force of a contract to which it was in reality a party, or as the simple consequence of a change of owners; by its fault or its misfortune; by a sale or by a trust. For, if it has done nothing, if what has happened, and all that has happened, is ascertained to be that the stockholders of the defendant, one or many, sold absolutely to the eleven men who constituted the board their entire stock, and the latter, by force of their proprietorship and as owners, have merely chosen directors, in their own interest, and are only managing their property in their own way as any absolute owners may; if that is the truth, and the entire and exact truth, it is difficult to see wherein the corporation has sinned, or what it has done beyond merely omitting for a time to carry on its business. That is the theory upon which the appellant stands, and which it submits to our examination.

which, as stockholders, they have themselves helped to commit. That again is corporate conduct, though there be an utter absence of directors' resolutions.

Is it asked what they could have done to prevent the organization of the trust, how they were negligent and unfaithful as corporate officers by their omission to act; what good a mere protest or objection would have accomplished; what effective form their resistance could have assumed? The answer is that they could have refused to recognize the illegal trust transfer of the stock; they could have declined to register the new ownership upon their stock books; they could have said, and acted upon their words, that the original stockholders remained not only the beneficial, but the legal owners of the stock; and, if the board of trustees appealed to the law, the resisting directors could challenge the legality of the transfer as molded by the combination agreement, and might have defeated the trust and shattered it at the outset of its career. So much they could have done as corporate officers; so much it was their duty to have done as representatives of the corporation, and when beyond that corporate neglect they recognized the validity of the stock transfers in trust, put the new and unlawful ownership upon their books, and accepted its votes in the choice of new directors, who were to throttle the independence of the corporation and chain it to the will of the trust, I think we must shut our eyes in willful blindness if we fail to see both corporate neglect and corporate action.

It is true, as we are reminded, that the statute confers upon trustees and directors general authority to manage the stock, property and concerns of manufacturing corporations; and equally true that, as a general rule and as between the companies and those with whom they deal, the corporate action must be manifested through and by the directors; but other statutes indicate with equal plainness that there are corporate acts which the trustees can not perform, and which affect and bind the corporation only upon the condition that they proceed from the stockholders, or from them and the trustees acting together. In increasing or diminishing the capital stock, the corporate act is wholly that of the corporators, and in consolidating two or more companies into one, there must be the joint action of both trustees and stockholders. The trust of

the refineries, in substance and effect, approached very near to these two corporate acts, so far as the resultant consequences affected the corporators acting. The trust stipulations practically doubled their corporate stock through the agency of the certificates issued, and the combination in its result is largely the equivalent of a substantial consolidation. If these things had been done lawfully, they would have been accomplished by the united action of trustees and corporators, and beyond any question would have been corporate acts. Having been done unlawfully, but by the same united agency aiming at similar results, they must still constitute corporate conduct, unless the bare fact of their illegality takes away their corporate character. To say that would disarm the state in every case of misuse or abuse of chartered powers.

The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law; and the substantial inquiry always is what in a given case has been that collective action and agency. As between the corporation and those with whom it deals the manner of its exercise usually is material, but as between it and the state, the substantial inquiry is only what that collective action and agency has done, what it has, in fact, accomplished, what is seen to be its effective work, what has been its conduct. It ought not to be otherwise. The state gave the franchise, the charter, not to the impalpable, intangible and almost nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men to be used by them, to redound to their benefit, to strengthen their hands and add energy to their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears. The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act collectively, as an aggregate body, without the least exception, and so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility of the corporation itself, we can not hesitate to conclude that there has been corporate conduct

which the state may review, and not be defeated by the assumed innocence of a convenient fiction. As was said in People, ex rel., v. K. & M. T. R. Co., 23 Wend. 193, "though the proceeding by information be against the corporate body, it is the acts or omissions of the individual corporators that are the subject of the judgment of the court."

It remains to determine whether the conduct of the defendant in participating in the creation of the trust, and becoming an element of it was illegal and tended to the public injury and we may consider the two questions together and without formal separation.

It is quite clear that the effect of the defendant's action was to divest itself of the essential and vital elements of its franchise by placing them in trust; to accept from the state the gift of corporate life only to disregard the conditions upon which it was given; to receive its powers and privileges merely to put them in pawn; and to give away to an irresponsible board its entire independence and self-control. When it had passed into the hands of the trust, only a shell of a corporation was left standing, as a seeming obedience to the law, but with its internal structure destroyed or removed. Its stockholders, retaining their beneficial interest, have separated from it in their voting power, and so parted with the control which the charter gave them and the state required them to exercise. It has a board of directors nominally and formally in office, but qualified by shares which they do not own, and owing their official life to the board which can end their power at any moment of disobedience. It can make no dividends whatever may be its net earnings, and must encumber its property at the command of its master, and for purposes wholly foreign to its own corporate interests and duties. At the command of that master it has ceased to refine sugar, and without any doubt for the purpose of so far lessening the market supply as to prevent what is termed "over-production." In all these respects it has wasted and perverted the privileges conferred by the charter, abused its powers, and proved unfaithful to its duties. But graver still is the illegal action substituted for the conduct which the state had a right to expect and require. It has helped to create an anomalous trust which is, in substance and effect, a partnership of twenty separate corporations.

The state permits in many ways an aggregation of capital, but mindful of the possible dangers to the people overbalancing the benefits, keeps upon it a restraining hand, and maintains over it a prudent supervision, where such aggregation depends upon its permission and grows out of its corporate grants. It is a violation of law for corporations to enter into a partnership. N. Y. & S. C. Co. v. F. Bank, 7 Wend. 412; Clearwater v. Meredith, 1 Wall. 29; Whittenton Mills v. Upton, 10 Gray 596. The case last cited furnishes the reasons with precision and at length. It shows the utter inconsistency of a double allegiance by those who act for the corporation to two different principals, and demonstrates that the vital characteristics of the corporation are of necessity drowned in the paramount authority of the partnership. That the combination of the refineries partakes of the nature of a partnership is not denied. Indeed, in one of the papers added to the appellant's brief, it is not only admitted, but asserted and defended. That paper shows quite clearly that by force of the arrangement there was a community of interest in the fund created by the corporate earnings before division, and that each member of the trust shared in the profit and loss of all. It is said, however, that a consolidation of manufacturing corporations is permitted by the law, and that the trust, or combination, or partnership, however it may be described, amounts only to a practical consolidation, which public policy does not forbid, because the statute permits it. Laws of 1867, ch. 960; Laws of 1884, ch. 367. The refineries did not avail themselves of that statute. They chose to disregard it, and to reach its practical results without subjection to the prudential restraints with which the state accompanied its permission.

If there had been a consolidation under the statute, one single corporation would have taken the place of the others dissolved. They would have disappeared utterly, and not, as under the trust, remained in apparent existence to threaten and menace other organizations and occupy the ground which otherwise would be left free. Under the statute the resultant combination would itself be a corporation deriving its existence from the state, owing duties and obligations to the state, and subject to the control and supervision of the state, and not, as here, an unincorporated board, a colossal and gigantic part-

nership, having no corporate functions and owing no corporate allegiance. Under the statute the consolidated company taking the place of the separate corporations could have as capital stock only an amount equal to the fair aggregate value of the rights and franchises of the companies absorbed; and not as here a capital stock double that value at the outset and capable of an elastic and irresponsible increase. The difference is very great and serves further to indicate the inherent illegality of the trust combination.

And here, I think, we gain a definite view of the injurious tendencies developed by its organization and operation, and of the public interests which are menaced by its action. As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest; and that to a much greater extent when beyond their own several aggregations of capital they compact them all into one combination which stands outside of the ward of the state, which dominates the range of an entire industry, and puts upon the market a capital stock proudly defiant of actual values, and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all these refineries, manned them with his own chosen agents, and managed them as a group at his sovereign will; for it is one thing for the state to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations.

The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine, and mass their forces in a solid trust or partnership, with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is opened to enormous combinations, vastly exceeding in number

and in strength and in their power over industry any possibilities of individual ownership; and the state by the creation of the artificial persons constituting the elements of the combination, and failing to limit and restrain their powers, becomes itself the responsible creator, the voluntary cause of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing, what it should cause and create is quite another.

And so we have reached our conclusion, and it appears to us to have been established, that the defendant corporation has violated its charter and failed in the performance of its corporate duties, and that in respects so material and important as to justify a judgment of dissolution. Having reached that result, it becomes needless to advance into the wider discussion over monopolies and competition and restraint of trade and the problems of political economy. Our duty is to leave them until some proper emergency compels their consideration. Without either approval or disapproval of the views expressed upon that branch of the case by the courts below, we are enabled to decide that in this state there can be no partnerships of separate and independent corporations, whether directly, or indirectly through the medium of a trust; no substantial consolidations which avoid and disregard the statutory permissions and restraints, but that manufacturing corporations must be and remain several as they were created, or one under the statute.

The judgment appealed from should be affirmed with costs.

All concur.

Judgment affirmed.

CHAPTER II.

FORMATION OF CORPORATIONS.

Acceptance of Charter.

THE STATE, EX REL., v. DAWSON.

16 Ind. 40. 1861.

Appeal from the Clark circuit court.

PERKINS, J. Information against the defendants, charging that they are pretending to be a corporation, and to act as such, when they are not a corporation. It charges that in January, 1849, the legislature of the state of Indiana enacted a special charter of incorporation (which is set out at length) for a railroad from Fort Wayne, Indiana, to Jeffersonville, to be called the Fort Wayne and Southern Railroad; that the persons named in the charter as directors did not accept said charter till June 2, 1852, when they did meet and accept the same, and organized under it. It is alleged that the defendants are assuming to act under said charter, never having organized under any other. The court below sustained a demurrer to the information, thus holding the defendants to be a legal corporation.

The present constitution of Indiana took effect on November 1, 1851. It contains these provisions:

"All laws now in force, and not inconsistent with this constitution, shall remain in force, until they shall expire or be repealed." Sched. (1 sub. sec.) of Constitution.

"Corporations, other than banking, shall not be created by special act, but may be formed under general laws." Art. xi, § 13.

"All acts of incorporation for municipal purposes shall continue in force under this constitution, until such time as the general assembly shall, in its discretion, modify or repeal the same." Sched. supra, sub. § 4.

The charter for the Fort Wayne and Southern Railroad was

not a charter for municipal purposes, and hence was not specially continued in existence. Article xi, § 13, above quoted, prohibits the creation of a corporation by special act or charter, that is, as we construe the prohibition, through or by virtue of, such special act or charter, after November 1, 1851. The policy that induced the prohibition, as well as its literal import, demands this construction. It is necessary for us to ascertain, then, when the defendants, if ever, were created a corporation. The simple enactment of the charter for the corporation by the legislature, did not create the corporation. It required one act on the part of the persons named in the charter to do that, viz.: acceptance of the charter enacted.

Says Grant in his work on corporations, vide, p. 13, "Nor can a charter be forced on any body of persons who do not choose to accept it." And again at p. 18, he says, "The fundamental rule is this: no charter of incorporation is of any effect until it is accepted by a majority of the grantees, or persons who are to be the corporators under it. Bagge's case, 2 Brownl. & G. 100, s. c. 1 Roll, Rep. 244; Dr. Askew's case, 4 Burr, 2200; Rutter v. Chapman, 8 M. & W. 25; per Wilmot, J., Rex v. Vice-Chancellor of Cambridge, 3 Burr, 1661. This is analogous to the general rule that a man can not be obliged to accept the grant or devise of an estate. Townson v. Tickell, 3 B. & Ald. 31." See, also, Ang. & Am., § 83, where it is said, if a charter is granted to those who do not apply for it, the grant is said to be in fieri till acceptance. We need not inquire whether this rule extends to municipal corporations in this country. As to what may constitute an acceptance we are not here called on to decide, as the information expressly shows that there was none in this case till June, 1852, which fact is admitted by the demurrer.

The grant of the charter in question, then, to those who had not applied for it, was but an offer, on the part of the state; a consent that the persons named in the charter might become a corporation: might be created such an artificial being by accepting the charter offered. But an offer, till accepted, may be withdrawn. In this case, the offer made by the state in 1849 was withdrawn by the state November 1, 1851, by them declaring that no corporation, after that date, should be

created except pursuant to regulations which she, in future, through her legislature would prescribe.

This pretended corporation, then, was not created before November 1, 1851, and it could be created afterward only by the concurrent consent of the state and the corporators. But, at that date, the constitution prohibited both the state and corporators from giving consent to such a corporation, to wit: One coming into existence through a special charter; and hence necessarily prohibited the creation thereof. This decision accords with that of the supreme court of the United States in Aspinwall v. Daviess County, 22 How., p. 364, where it was held that the new constitution prohibited a subscription of stock to the Ohio and Mississippi Railroad Company, authorized by the charter of the corporation, granted under the former constitution and actually voted by the people of the county under that constitution.

Whether, as a matter of fact, the charter in this case was accepted under the old constitution, must be determined on a trial of the cause below.

Had the provision in our constitution, like that on this subject in the constitution of Ohio, ordained that the legislature should "pass no special act conferring powers," the restraint would clearly have been imposed alone upon future legislative action; but, in our constitution, the restraint is plainly imposed upon the creation, the organization of the corporation itself. See The State v. Roosa, 11 Ohio St. Rep. 16.

Per Curiam.—The judgment is reversed with costs. Cause remanded for further proceedings in accordance with this opinion.

Creation Under General Laws. Delegation of Power.

FRANKLIN BRIDGE CO. v. WOOD.

14 Ga. 80. 1853.

Assumpsit in Heard Superior Court.

The Franklin Bridge Company was incorporated under the Act of the Legislature of 1843, to prescribe the mode of incorporating companies for certain purposes, by an order of the Inferior Court of Heard County.

The company sued the defendant, Wood, for his subscription to their stock.

The defendant pleaded that the company was not legally incorporated; contending that the act of the legislature referred to, was unconstitutional and void.

Upon argument, the court held that the act aforesaid was unconstitutional, and nonsuited the plaintiffs.

To this decision plaintiff excepted.

LUMPKIN, J.—Is the Act of 1843 and that of 1845, amendatory thereof, pointing out the manner of creating certain corporations and defining their rights, privileges, and liabilities, unconstitutional?

By the first section of the Act of 1843, it is provided "That when the persons interested shall desire to have any church, camp-ground, manufacturing company, trading company, ice company, fire company, theatre company, or hotel company, bridge company, and ferry company, incorporated, they shall petition in writing the Superior or Inferior Court of the county where such association may have been formed, or may desire to transact business for that purpose, setting forth the object of their association, and the privilege they desire to exercise, together with the name and style by which they desire to be incorporated; and said court shall pass a rule or order, directing said petition to be entered of record on the minutes of said court."

Section 2 enacts "That when such rule or order is passed, and said petition is entered of record, the said companies or associations shall have power respectively, under and by the name designated in their petition, to have and use a common seal; to contract and be contracted with; to sue and be sued; to answer and be answered unto in any court of law or equity; to appoint such officers as they may deem necessary; and to make such rules and regulations as they may think proper for their own government; not contrary to the laws of this State; but shall make no contracts or purchase or hold any property of any kind, except such as may be absolutely necessary to carry into effect the object of their incorporation. Nothing herein contained shall be so construed as to confer banking or insurance privileges on any company or association herein

enumerated; and the individual members of such manufacturing, trading, theatre, ice, and hotel companies, shall be bound for the punctual payment of all the contracts of said companies, as in case of partnership."

The third section declares that "No company or association shall be incorporated under this act, for a longer period than fourteen years; but the same may be renewed whenever necessary, according to the provisions of the first section of this act."

The fourth section confers upon the Superior and Inferior Courts respectively, the power to change the names of individuals.

Section fifth. "For entering any of said petitions and orders, and furnishing a certified copy thereof, the clerk shall be entitled to a fee of five dollars; except in cases of applications by individuals for the change of names,—in which case, the clerk of said court shall be entitled to the fee of one dollar. And that such certified copy shall be evidence of the matters therein stated in any court of law and equity in this State." Cobb's Digest, 542, 543.

By the Act of 1845 the provisions of the Act of 1843 are extended to all associations, and companies whatever, except banks and insurance companies; and the individual members of all such incorporations are made personally liable for all the contracts of said associations or companies. Ibid.

The argument against the validity of the charter of the Franklin Bridge Company, created under these statutes, is this:—

1. That in England, corporations are created and exist by prescription, by Royal Charter, and by Act of Parliament. With us they are created by authority of the Legislature, and not otherwise. That to establish a corporation is to enact a law; and that no power but the legislative body can do this.

2. That legislative power is vested under our Constitution, in the General Assembly, to consist of a Senate and House of Representatives, to be elected at stated periods by the citizens of the respective counties.

3. And that the General Assembly is bound to exercise the power of making laws thus conferred upon them by the people in the primordial compact, in the mode therein prescribed,

and in none other; and that a law made in any other mode is unconstitutional and void. That the Legislature is but the agent of their constituents; and that they cannot transfer authority delegated to them to any other body, corporate or otherwise,—not even to the Judiciary, a co-ordinate department of the government, unless expressly empowered by the Constitution to do so. That to do this would be to violate one of the fundamental maxims of jurisprudence as well as of political science, namely, delegata potestas non potest delegari. * * *

4. It was formerly asserted that in England the act of incorporation must be the immediate act of the king himself, and that he could not grant a license to another to create a corporation. 10 Reports, 27. But Messrs. Angell and Ames, in their Treatise on Corporations, state that the law has since been settled to the contrary; and that the king may not only grant a license to a subject to erect a particular corporation, but give a general power by charter to erect corporations indefinitely, on the principle that qui facit per alium facit per se; that the persons to whom the power is delegated of establishing corporations, are only an instrument in the hands of the government. 1 Kyd, 50; 1 Black. Com.; Ang. & Am. 63.

Before the revolution, charters of incorporation were granted by the proprietaries of Pennsylvania under a derivative authority from the Crown; and those charters have since been recognized as valid. 3 Wilson's Lectures, 409. A similar power has been delegated by the Legislature of Pennsylvania with regard to churches. 7 S. & R. 517.

The acts of the instrument in these cases become the acts of the mover, under the familiar maxim above mentioned. See also 1 Missouri R. 5.

5. Our opinion is that no legislative power is delegated to the courts by the acts under consideration. There is simply a ministerial act to be performed,—no discretion is given to the courts. The duty of passing the rule or order directing the petition of the corporators to be entered of record on the minutes of the court, setting forth to the public the object of the association and the privilege they desire to exercise, together with the name and style by which they are to be called and known, is made obligatory upon the courts; and should

they refuse to discharge it, a mandamus would lie to coerce them. It is true the Legislature has seen fit to use the courts for the purpose of giving legal form to these companies. But it might have been done in any other way. Under the Free Banking Law of 1838, instead of petitioning the court, and having the order passed and entered upon its minutes, the certificate specifying the name of the association, its place of doing business, the amount of its capital stock, the names and residence of the shareholders, and the time for which the company was organized, is required merely to be proven and acknowledged, and recorded in the office of the clerk of the Superior Court, where any office of the association is established, and a copy filed with the Comptroller General. Cobb's Digest, 107, 108.

And so under the Act of 1847, authorizing the citizens of this State, and such others as they may associate with them, to prosecute the business of manufacturing with corporate powers and privileges. The persons who propose to embark in that branch of business are required to draw up a declaration specifying the objects of their association and the particular branch of business they intend carrying on, together with the name by which they will be known as a corporation, and the amount of capital to be employed by them; which declaration is required to be first recorded in the clerk's office of the Superior Court of the county where such corporation is located, and published once a week for two months in the two nearest Gazettes; which being done, it is declared that said association shall become a body corporate and politic, and known as such, without being specially pleaded, in all courts of law and equity in this State, to be governed by the provisions and be subject to the liabilities therein specified. Cobb's Digest, 439, 440.

In these two instances, and others which might be cited, the Legislature have dispensed with the action of the courts, or of any other agency, to carry out their enactments with regard to these various associations which have become the usual and favorite mode of conducting the industrial pursuits of the civilized world in modern times.

All these Statutes were complete as laws when they came from the hands of the Legislature, and did not depend for their force and efficacy upon the action or will of any other power.

It is true that they could only take effect upon the happening of some event, such as the filing the petition or declaration, and giving publicity to the purpose of the association in the mode prescribed by the act. But if this were a good reason for regarding these statutes as invalid, then how few corporations could abide the test! For it requires the acceptance of the charter to create a corporate body; for the government cannot compel persons to become an incorporated body without their consent. And this consent, either express or implied, is generally subsequent in point of time to the creation of the charter. And yet, no charter that we are aware of has been adjudged invalid, because the law creating it and previously defining its powers, rights, capacities, and liabilities, did not take effect until the acceptance of the corporate body, or at least a majority of them, was signified.

The result therefore of our deliberation upon this case is, that the Acts of 1843 and 1845, vesting in all associations, except for banking and insurance, the power of self-incorporation, do not impugn the Constitution, and that the charter of the Franklin Bridge Company and all others created under them, and in conformity to their provisions, are legal and valid. With the policy of these Statutes we have nothing to do. The province of this and all other courts is jus dicere, not jus dare.

Judgment reversed.

CHAPTER III.

IRREGULARLY AND DEFECTIVELY ORGANIZED CORPORATIONS.

Conditions of De Facto Corporate Existence.

FINNEGAN v. NOERENBERG.

52 Minn. 239, 53 N. W. 1150, 38 Am. St. Rep. 552. 1893.

GILFILLAN, C. J. Eight persons signed, acknowledged and caused to be filed and recorded in the office of the city clerk in Minneapolis, articles assuming and purporting to form, under laws of 1870, ch. 29, a corporation, for the purpose, as specified in them, of "buying, owning, improving, selling and leasing of lands, tenements and hereditaments, real, personal and mixed estates and property, including the construction and leasing of a building in the city of Minneapolis, Minn., as a hall to aid and carry out the general purposes of the organization known as the 'Knights of Labor.'" The association received subscriptions to its capital stock, elected directors and a board of managers, adopted by-laws, bought a lot, erected a building on it, and, when completed, rented different parts of it to different parties. The plaintiff furnished plumbing for the building during its construction, amounting to $599.50, for which he brings this action against several subscribers to the stock, as co-partners, doing business under the firm name of the "K. of L. Building Association." The theory upon which the action is brought is that, the association having failed to become a corporation, it is in law a partnership, and the members liable as partners for the debts incurred by it.

It is claimed that the association was not an incorporation because—first, the act under which it attempted to become incorporated, to wit Laws 1879, ch. 29, is void, because its subject is not properly expressed in the title; second, the act does

not authorize the formation of corporations for the purpose or to transact the business stated in the articles; third, the place where the business was to be carried on was not distinctly stated in the articles, and they had, perhaps, some other minor defects.

It is unnecessary to consider whether this was a de jure corporation, so that it could defend against a quo warranto, or an action in the nature of a quo warranto, in behalf of the state; for although an association may not be able to justify itself when called on by the state to show by what authority it assumes to be and act as a corporation, it may be so far a corporation that, for reasons of public policy no one but the state will be permitted to call in question the lawfulness of its organization. Such is what is termed a corporation de facto, that is, a corporation from the fact of its acting as such, though not in law or of right a corporation. What is essential to constitute a body of men a de facto corporation is stated by Selden, J., in Methodist, etc., Church v. Pickett, 19 N. Y. 482, as "(1) the existence of a charter or some law under which a corporation with the powers assumed might lawfully be created; and (2) a user by the party to the suit of the rights claimed to be conferred by such a charter or law." This statement was apparently adopted by this court in East Norway Church v. Froislie, 37 Minn. 447, 35 N. W. Rep. 260, but as it leaves out of account any attempt to organize under the charter of law, we think the statement of what is essential defective. The definition in Taylor on Private Corporations (page 145) is more nearly accurate: "When a body of men are acting as a corporation, under color of apparent organization, in pursuance of some charter or enabling act, their authority to act as a corporation can not be questioned collaterally."

To give a body of men assuming to act as a corporation, where there has been no attempt to comply with the provisions of any law authorizing them to become such, the status of a de facto corporation might open the door to frauds upon the public. It would certainly be impolitic to permit a number of men to have the status of a corporation to any extent merely because there is a law under which they might have become incorporated, and they have agreed among themselves to act, and they have acted, as a corporation. That was the condition

in Johnson v. Corser, 34 Minn. 355, 25 N. W. Rep. 799, in which it was held that what had been done was ineffectual to limit the individual liability of the associates. They had not gone far enough to become a de facto corporation. They had merely signed the articles, but had not attempted to give them publicity by filing for record, which the statute required.

"Color of apparent organization under some charter or enabling act" does not mean that there shall have been a full compliance with what the law requires to be done, nor a substantial compliance. A substantial compliance will make a corporation de jure, but there must be an apparent attempt to perfect an organization under the law. There being such apparent attempt to perfect an organization, the failure as to some substantial requirement will prevent the body being a corporation de jure; but, if there be user pursuant to such attempted organization, it will not prevent it being a corporation de facto.

The title to chapter 29 is "an act in relation to the formation of co-operative associations." Appellant's counsel argues that the body of the act does not contain a single element of "co-operation," as that term is generally understood. But how it is generally understood he does not inform us. In a broad sense, all associations, whether corporations or partnerships, are co-operative, for all the members, either by their labor or capital, or both, co-operate to a common purpose. There is undoubtedly, in popular use of the terms, a more limited sense, though the precise limits are not well defined. There is no legal, as distinguishable from their popular signification. In the Century Dictionary the term "co-operative society" is defined, "a union of individuals, commonly laborers or small capitalists, formed * * * for the prosecution in common of a productive enterprise, the profits being shared in accordance with the amount of capital or labor contributed by each member." Taking the distinctive feature of a co-operative society to be that it is made up of laborers or small capitalists, it is manifest that the chapter intends to deal with just that sort of associations. Not only does it contemplate that the operations of the corporations shall be local, but the capital stock is limited to $50,000, the stock which one member may hold to $1,000. No one can become a shareholder without

the consent of the managers, and no one is entitled to more than one vote.

The provisions in the body of the act are in accord with the title, and it is therefore not open to the objection made against it.

The purposes for which, under the act, corporations may be formed, are "of trade, or of carrying on any lawful mechanical, manufacturing or agricultural business." The main purpose of the act being to enable men of small capital, or of no capital but their labor and their skill in trades, to form corporations, for the purpose of giving employment to such capital or labor and skill, and language expressing the purposes for which such corporations may be formed ought not to be narrowly construed. Giving a reasonably liberal meaning to the word "trade" in the act, it would include the buying and selling of real estate, and, upon a similar construction, the word "mechanical" would include the erection of buildings. The doing of the mason, or brick, or carpenter, or any other work upon a building is certainly mechanical. There can be little question that corporations might be formed to do either of those kinds of work on buildings, and, that being so, there is no reason why they may not be formed to do all of them. There is no reason to claim that such a corporation must do its work as a contractor for some other person. It may do it for itself, and, as the act authorizes the corporation to "take, hold and convey such real and personal estate as is necessary for the purposes of its organization," it may, instead of working for others as a contractor, make its profit by buying real estate, erecting buildings on it, and either selling or holding them for leasing.

The omission to state distinctly in the articles the place within which the business is to be carried on, though that might be essential to make it a de jure corporation, would not prevent it becoming one de facto.

The foundation for a de facto corporation having been laid by the attempt to organize under the law, the user shown was sufficient.

Judgment affirmed.

CLARK v. AMERICAN CANNEL COAL CO.

165 Ind. 213, 73 N. E. 1083. 1905.

Suit by the American Cannel Coal Co. against Emma L. Clark. From a decree for plaintiff, defendant appeals. Reversed.

MONKS, J.—This suit was brought by appellee to enjoin appellant from mining and removing fire-clay from certain real estate in Perry county, and to quiet appellee's title to said fire-clay. Appellee sold and conveyed said real estate by deed to a remote grantor of appellant on September 20, 1866, and claims to own said fire-clay by virtue of the reservation contained in said deed. A trial of said cause resulted in a final decree quieting appellee's title to said fire-clay and enjoining appellant from removing the same.

The first question to be determined is: was appellee, when it commenced this suit, an existing corporation having the power to sue? If this question be answered in the negative this case must be reversed. It appears from the record that appellee—a corporation—was created by special act (Local Laws 1838, p. 216), to continue for a period of fifty years from December 23, 1837. The powers granted were to mine for coal, "purchase, receive, hold and enjoy lands, coal, iron and other mines, * * * and the same to sell, convey and demise." In 1885 the legislature passed an act (Acts 1885, p. 121, §§ 5124-5128, Burns 1901), which purported to extend the corporate existence of every private corporation, created or organized by special act for the purposes of mining stone, coal, iron ore, etc., thirty years after the passage of said act, whose board of directors, within sixty days after the passage of said act of 1885, shall avail itself of the provisions of said act by adopting resolutions to that effect, and filing the same with a statement giving the title and date of the act creating said corporation and of each act amendatory or supplemental to said creative act. The board of directors of appellee complied with the requirements of said act of 1885 on May 30, 1885, and appellee claims that thereby its corporate existence was extended thirty years from that time. Since 1837 until the commencement of

this action appellee has exercised corporate powers under said special act of 1837 and the act of 1885. Appellant's position is that, as the special act of December 23, 1837, creating appellee a corporation, fixed the life of said corporation at fifty years, it ceased to exist when that period was ended, in 1887; that said act of 1885 was unconstitutional, and the attempt to continue the corporate existence of appellee by complying with its provisions was without effect; that appellee having ceased to exist as a corporation, cannot maintain this action. The act of April 2, 1885, supra, which appellee claims continued its corporate existence for thirty years from the date of its passage, is clearly unconstitutional under the rule declared In re Bank of Commerce (1889), 153 Ind. 460, 47 L. R. A. 489.

Appellee insists, however, that appellant cannot raise any question in regard to the constitutionality of said act of 1885 in this case, because (1) it is at least a de facto corporation, and therefore impervious to collateral attack; (2) that appellant is estopped from denying its corporate existence. It is true, as claimed by appellee, that the corporate existence of a de facto corporation can only be questioned in a direct proceeding brought for that purpose. Doty v. Patterson (1900), 155 Ind. 60, 64, and authorities cited. It is essential to the existence of a de facto corporation, however, that there be (1) a valid law under which a corporation with the powers assumed might be incorporated; (2) a bona fide attempt to organize a corporation under such law; (3) and an actual exercise of corporate powers. Doty v. Patterson, supra; 10 Cyc. Law & Proc., 252-256; 1 Clark & Marshall, Priv. Corp., §§82a, 82b. It follows, therefore, that there cannot be a corporation de facto when there cannot be one de jure. If there is no law under which a corporation de jure might exist, its nonexistence may be set up even in a collateral proceeding. * * * "To be a corporation de facto it must be possible to be a corporation de jure, and acts done in the former case must be legally authorized to be done in the latter, or they are not protected or sanctioned by the law. Such acts must have an apparent right." Evenson v. Ellingson (1887), 67 Wis. 634, 646, 31 N. W. 342. It necessarily follows that there cannot be a corporation de facto under an unconstitutional

statute, for such a statute is void, and a void law is no law. 1 Clark & Marshall, Pri. Corp., p. 246; Black, Const. Law, p. 64; Snyder v. Studebaker, supra; Harriman v. Southam, supra; Heaston v. Cincinnati, etc., R. Co., supra; Eaton v. Walker, supra; Norton v. Shelby County (1886), 118 U. S. 425, 6 Sup. Ct. 1121, 3 L. ed. 178.

If the law under which a corporation is organized, or the special act creating the corporation, fixes a definite time when its corporate life must end, it is evident that when that date is reached, said corporation is ipso facto dissolved without any direct action on the part of the state or its members. And no corporate powers can thereafter be exercised by it except such as are given it by statute for the purpose of winding up its affairs, which in this State is limited to three years after the dissolution. * * *

Appellee in 1866 at the time its deed for the land in controversy was executed to appellant's remote grantor, was a corporation de jure by virtue of the special law of December 23, 1837 (Local Laws 1838, p. 216). Even if appellant who claims the real estate in controversy and the right to mine said fireclay and remove the same under appellee's deed of September 20, 1866, is estopped to deny its corporate existence, such estoppel only operates to prevent a denial of its corporate existence at the time the deed was executed in 1866, and in no way prevents appellant from alleging facts showing that the period fixed for its existence as a corporation expired in 1887, and that there was no such corporation in existence when this action was commenced. This is true because after a corporation is dissolved by a judicial decree or by the expiration of the period fixed for its existence in the law under which it is organized, it is not even a de facto corporation, and its existence as a corporation may be questioned collaterally. * * *

As the corporate existence of appellee fixed by the special act of 1837 ended in 1887, and the three years given by § 3429, Burns 1901, §3006 R. S. 1881 and Horner 1901, for the purpose of winding up its affairs ended in 1890, and the act of 1885 (Acts 1885, p. 121), under which appellee claims its corporate existence was extended thirty years, is unconstitutional, it follows that appellee had no power to sue when this action was commenced.

Judgment reversed, with instructions to sustain appellant's motion for a new trial of the issues joined on the answers in abatement, and for further proceedings in accordance with this opinion.

Effect of Want of Good Faith.

MONTGOMERY ET AL. v. FORBES.

148 Mass. 249, 19 N. E. 342. 1889.

C. ALLEN, J.—The apparent corporation was not a corporation. The statute of New Hampshire requires five associates, and the articles of agreement must be recorded in the town in which the principal business is to be carried on, and the place in which the business is to be carried on must be distinctly stated in the articles; otherwise there is no corporation. The defendant's pretended associates were associates only in name; he alone was interested in the enterprise. The articles of agreement were recorded in Nashua, and stated that the business was to be carried on there; but it was not in fact carried on there, and was not intended to be. The defendant took all the shares of the capital stock, and paid into himself as treasurer only 50 per cent of the amount thereof. This is not a case where there has been a defective organization of a corporation which has a legal existence under a valid charter. Here there was no corporation. It was just the same as if the defendant had done nothing at all in the way of establishing a corporation, but had conducted his business under the name of the Forbes Woolen Mills, calling it a corporation. The business was his personal business, which he transacted under that name. Fuller v. Hooper, 3 Gray 334, 341. Bryant v. Eastman, 7 Cush. 111.

The jury found that he did not, in good faith, attempt to organize the corporation, but that he believed it to be a valid corporation. His belief, in view of the facts of the case, is immaterial. Under this state of things, the defendant bought goods of the plaintiffs for his own sole benefit, adopting the name of the apparent corporation, which had no real existence, and which represented nobody but himself. He can not escape responsibility for his purchases by the device of putting such a

mere name between himself and the plaintiffs. The purchase was in substance by and for himself alone. The plaintiffs might have repudiated the transaction, and maintained replevin, if they had learned the facts in time. They may also treat the transaction as a sale to the defendant personally. Fay v. Noble, 7 Cush. 188, 194; Kelner v. Baxter, L. R. 2 C. P. 174, 183, 185; 2 Kent Com. (13th ed.) 630.

Since the notes represented nothing, the plaintiffs were at liberty to treat them as void and recover on the original contract for goods sold. Melledge v. Boston Iron Co., 5 Cush. 158, 171.

Verdict to stand.

CHAPTER IV.

PROMOTION OF CORPORATIONS.

Promoters Defined.

THE TELEGRAPH v. LOETSCHER.

127 Iowa 383, 101 N. W. 773. 1904.

Action in behalf of the Dubuque Specialty Machine Works for money received by Christian Loetscher for promoting the Dubuque Specialty Machine Works, and in aiding another to dispose of property to it. Judgment as prayed, and Loetscher appeals.

LADD, J.—In April, 1891, A. Ferris Smith was owner of a certain patent right on a mortising machine, and of machinery to manufacture the device. He suggested to citizens of Dubuque the propriety of organizing a company which should purchase these. Thereupon the defendant and two others were appointed by a local board of trade as a committee to go to Chicago, Ill., to examine the mortising machine. Howie and the defendant did so, and seem to have reported that, though not perfect, the invention was valuable. About a week later Smith returned to Dubuque, and, after some parley, induced the defendant, who was superintendent of the Farley & Loetscher Manufacturing Company, to permit him to have the mortising machine set up in its factory for exhibition. He also arranged with Loetscher to help him promote a company for the purchase of the patent and machinery to manufacture the mortising machine. The terms of the agreement are not open to serious doubt, though controverted in argument; the defendant insisting that he was merely to aid in organization of the company, and not in the sale of the patents and machine to it after being organized. The distinction is due to his construction of the contract. The object in organizing the company was that it should acquire the property of Smith, and

this was perfectly understood by Loetscher. In a deposition taken in 1896 he testified that Smith proposed that "he would have two hundred shares, or $20,000, issued to me, if I would help promote this company. Told him I didn't want any stock, because, if I should get any, I would subscribe for a little myself. Finally told him if he would give me $10,000 cash, or its equivalent, I would take hold of the matter and help him push it through. He claimed the company should be organized for $200,000, and he should get 95-200 of the stock and $50,000 cash for his patent, and he worked along that basis for about a month. Finally Dr. Staples and other prominent men took hold of it, and commenced to deal with Smith. They objected to the amount of cash to be paid to Smith. Smith said to me: 'I'll have to reduce my cash bonus, and I want you to reduce yours.' He said he would take $25,000 in cash, provided I would be willing to take $5,000. He made an agreement to pay me $5,000 cash if the company was organized; otherwise I was not to have anything. I subscribed for the stock myself then, and others subscribed through my influence. That is about the way the company was started."

The very purpose of organizing the company was to buy of Smith and to manufacture the mortising machines. The subscription paper the defendant helped circulate recited that "the assets of the company and the franchise are the deeds of patent of the United States,' etc. Manifestly Loetscher was to do precisely what he testified—"Take hold and help him push it through." To accomplish this, it was not only necessary to organize the company, but to have it purchase the patent and machinery. This was Smith's ultimate object, as defendant knew; and it was to bring this about, as well as to secure subscribers for stock, that the agreement bound him to help Smith accomplish. This view is further confirmed by the fact that no settlement was made until after the entire deal was consummated. Defendant denies that he was to do more than help organize the company, and insists that he demanded payment as soon as this was done; but this is merely his construction of what was said between him and Smith, and is not borne out by his testimony of the conversation had between them, and is inconsistent with the circumstances sur-

rounding the transaction. The defendant exhibited the machine at the factory to prospective subscribers, and requested acquaintances to take stock in the company. As a machinist and inventor, his neighbors reposed confidence in him, and were unaware that he was in the secret employ of Smith. Stock to the amount of $75,000 was subscribed, and on the 25th day of May a preliminary organization was perfected, with defendant as one of the signers of the articles of incorporation and one of the directors, and afterwards as vice-president. As such officer he was present at nearly all the meetings of the board of directors, and advised and participated in the purchase of patents and machinery from Smith for which $6,000 was paid in cash, and 95-200 of the stock issued; and he was also to have $14,000 out of the first net earnings of the company. It is not material that Smith was paid less than originally contemplated in his contract with the defendant. The important facts are that the defendant, while acting as promoter in organizing the corporation for the express purpose of buying these patents and machinery, and acting as a director of the company after it was organized, was in the secret employment of Smith, from whom the purchase was made. It is idle to talk about compensation for services in such a case. The payment is for the influence the party may exert with those who trust him, and too often, though not in this instance, amounts to a betrayal of confidence for money. That his engagement was such as to constitute him a promoter, the record leaves no doubt. A promoter has been defined to be one who brings about the incorporation and organization of a company; who brings together the persons who become interested in the enterprise; who aids in procuring subscriptions, and sets in motion the machinery which leads to the formation of the corporation itself. 2 Cook on Stockholders, section 651. It is said to be a business, not a legal, term, "usually summing up in a single word a number of business operations, familiar to the commercial world, by which a company is generally brought into existence." Bowen, J., in Whaley Bridge Calico Printing Co. v. Green, 28 Wkly. Rep. (Q. B. Div. 1880) 351.

That such persons occupy a fiduciary relation toward the corporation they seek to promote is settled by the authorities.

See 23 Am. & Eng. Enc. of Law, 234. In Bosher v. Richmond, etc., Land Co., 89 Va. 455 (16 S. E. 360, 37 Am. St. Rep. 879), the court said:

"A promoter is a person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation itself. Every person, acting by whatever name in the forming and establishing of a company at any period prior to the company, is considered, in law, as occupying a fiduciary relation towards the corporation. He is an agent of the corporation, and is subject to the disabilities of such. He is guilty of a breach of trust if he sells property to the corporation, purchased after he began promoting, without informing the company that the property belongs to him, or he may commit a breach of trust by accepting a bonus or commission from a person who sells property to that corporation."

The promoter is in the situation akin to that of agent or trustee of the company, and his dealings with it must be open and fair. Says Morawetz in his work on Corporations, section 546:

"If persons start a company, and induce others to subscribe for shares, for the purpose of selling property to the company when organized, they must faithfully disclose all facts relating to the property which would influence those who form the company in deciding upon the judiciousness of the purchase. If the promoters are guilty of any misrepresentation of facts or suppression of the truth in relation to the character and value of the property, or their personal interest in the proposed sale, the company will be entitled to set aside the transaction, or recover any compensation for any loss which it has suffered."

The principle is not different from that involved when several persons are engaged in a joint enterprise for their mutual benefit. Each has the right to demand and expect from his associates good faith in all that relates to their common interests, and no one will be permitted to take to himself a secret and separate advantage to the prejudice of the others. Getty v. Devlin, 54 N. Y. 403. The principle was forcibly expressed

by the Lord Chancellor in Erlanger v. New Sombrero Phosphate Co., L. R., 3 App. Cases, 1218:

"They stand, in my opinion, undoubtedly, in a fiduciary position. They have in their hands the creation and molding of the company. They have the power of defining how and when and in what shape and under what supervision it shall start into existence and begin to act as a trading corporation. If they are doing all this in order that the company may, as soon as it starts into life, become, through its managing directors, the purchasers of the property of themselves (the promoters), it is, in my opinion, incumbent upon the promoters to take care that in forming the company they provide it with an executive (that is to say, with a board of directors) who shall both be aware that the property which they are asked to buy is the property of the promoters, and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote and form a joint-stock company, and then sell his property to it; but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to the promoter but to some other person."

In re North Australian Co. (Archer's Case) L. R. 1892, Ch. Div. vol. 1, page 322, Archer, being requested by the promoter to become a director, agreed to do so on the former's promise that, if he should at any time wish to part with his shares, he would purchase them at the price Archer paid. After acting some time as director, Archer resigned, and the promoter took his shares at the price agreed. At that time the shares had no market value. The liquidators of the company asked that Archer be required to pay in the amount he had received from the promoter, with interest; and it was held that having regard to his position as director of, and therefore agent for, the company, whatever benefit or profit accrued to him under the indemnity constituted by his secret agreement with the promoter belonged to the company, and that the retention by him of the proceeds of the indemnity occasioned a loss to the company, for which he was accountable, with interest. In Yale

Gas Stove Co. v. Wilcox, 64 Conn. 101 (29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159), Foley and Wilcox agreed that the latter should organize a corporation, to which the former should transfer certain patents at twice the price he was ready to take for them and $5,000 in capital stock, and of this Wilcox should receive one-half. The company was held entitled to recover from Wilcox all he had received. In Chandler v. Bacon (C. C.) 30 Fed. 539, Bacon & Cardoc were promoters of the National Color Printing Company, to be formed, and as such negotiated an agreement between the owners of certain patents by which they were to receive two-sixteenths of its capital stock, less 625 shares which were to be given to one Piper. Bacon was to be elected president, and Cardoc secretary. They offered and sold stock to the public at $7 per share representing that the patents were to be paid for, but without disclosing the secret agreement by which they were to receive two-sixteenths of the stock without consideration. They were held liable to the receiver of the corporation for the value of the stock at the rate for which they disposed of other stock. See note to Pittsburgh Mining Co. v. Spooner, 17 Am. St. Rep. 161. The authorities are numerous, and our purpose has been to call attention to a few of the leading ones only.

As promoter and director, the relation of defendant to the company was that of agent, and it is elementary that an agent is disqualified from representing his principal in any transaction in which his personal interests are opposed to the interests of the principal. This rule applies in all cases where there is danger that the agent may be induced to use his powers as agent for his own advantage. The character of the interest is immaterial, provided it is substantial. While duplicity on his part may in a proper case prove a just ground for rescission, his principal may ratify the deal, and claim all the advantages, including any bonus or commission paid the agent by the other party. Indeed, the right of recovery in event of finding it a part of appellant's engagement with Smith to aid him in disposing of his property to the company is not seriously questioned. Affirmed.

Compensation of Promoters.

GENT v. MUTUAL INSURANCE COMPANY.

107 Ill. 652. 1883.

WALKER, J. * * * That a corporation should have a full and complete organization and existence as an entity before it can enter into any kind of a contract or transact any business would seem to be self-evident. This is unconditionally true, unless the act of incorporation authorizes the corporators to perform acts and enter into contracts to bind the company when it shall be organized. As well say a child in *ventre sa mere* may enter into a contract, or that its parents may bind it by contract. A corporation, until organized, has no being, franchises or faculties. Nor do those engaged in bringing it into being have any power to bind it by contract, unless so authorized by the charter. Until organized as authorized by the charter there is not a corporation, nor does it possess franchises or faculties for it or others to exercise until it acquires a complete existence. By its birth, so to speak, it for the first time acquires its faculties to transact its business and perform its functions. * * *

In the case of Rockford, Rock Island and St. Louis R. Co. v. Sage, 65 Ill. 328, it was held that a railroad incorporation was not liable for services rendered before its organization, unless the company promised to pay after it was organized. In Stowe v. Flagg, 72 Ill. 397, it was held that the agreement of parties intending to and engaged in forming a manufacturing corporation to put in property as stock, but which never was subscribed, did not bind the corporation, nor did the property become that of the corporation, although it was used by the company. In the case of Western Screw and Manufacturing Co. v. Cousley, 72 Ill. 531, it was held where the corporators, before the organization of the company was completed, employed a superintendent, and he entered upon the duties of the place, and rendered services for the inchoate company, it, when organized, was not liable to pay for such services. * * *

Promoters' Contracts: Ratification or Adoption.

McARTHUR v. TIMES PRINTING COMPANY.

48 Minn. 319, 51 N. W. 216, 31 Am. St. Rep. 653. 1892.

MITCHELL, J.—The complaint alleges that about October 1, 1889, the defendant contracted with plaintiff for his services as advertising solicitor for one year; that in April, 1890, it discharged him in violation of the contract. The action is to recover damages for the breach of the contract. The answer sets up two defenses: (1) That plaintiff's employment was not for any stated time, but only from week to week; (2) that he was discharged for good cause. Upon the trial there was evidence reasonably tending to prove that in September, 1889, one C. A. Nimocks and others were engaged as promoters in procuring the organization of the defendant company to publish a newspaper; that, about September 12, Nimocks, as such promoter, made a contract with plaintiff, in behalf of the contemplated company, for his services as advertising solicitor for the period of one year from and after October 1,—the date at which it was expected that the company would be organized; that the corporation was not, in fact, organized until October 16, but that the publication of the paper was commenced by the promoters October 1, at which date plaintiff, in pursuance of his arrangement with Nimocks, entered upon the discharge of his duties as advertising solicitor for the paper; that after the organization of the company he continued in its employment in the same capacity until discharged, the following April; that defendant's board of directors never took any formal action with reference to the contract made in its behalf by Nimocks, but all of the stockholders, directors, and officers of the corporation knew of this contract at the time of its organization, or were informed of it soon afterwards, and none of them objected to or repudiated it, but, on the contrary, retained plaintiff in the employment of the company without any other or new contract as to his services.

There is a line of cases which hold that where a contract is made in behalf of, and for the benefit of, a projected corporation, the corporation, after its organization, can not become a

party to the contract, either by adoption or ratification of it. Abbott v. Hapgood, 150 Mass. 248, 22 N. E. Rep. 907; Beach Corp., section 198. This, however, seems to be more a question of name than of substance; that is, whether the liability of the corporation, in such cases, is to be placed on the grounds of its adoption of the contract of its promoters, or upon some other ground, such as equitable estoppel. This court, in accordance with what we deem sound reason, as well as the weight of authority, has held that, while a corporation is not bound by engagements made on its behalf by its promoters, before its organization, it may, after its organization, make such engagements its own contracts. And this it may do precisely as it might make similar original contracts; formal action of its board of directors being necessary only where it would be necessary in the case of a similar original contract. That it is not requisite that such adoption or acceptance be expressed, but it may be inferred from acts or acquiescence on the part of the corporation, or its authorized agents, as any similar original contract might be shown. Battelle v. Northwestern Cement and Concrete Pavement Co., 37 Minn. 89, 33 N. W. Rep. 327. See, also, Mor. Corp., section 548. The right of the corporate agents to adopt an agreement originally made by promoters depends upon the purposes of the corporation and the nature of the agreement. Of course, the agreement must be one which the corporation itself could make, and one which the usual agents of the company have express or implied authority to make. That the contract in this case was of that kind is very clear; and the acts and acquiescence of the corporate officers, after the organization of the company, fully justified the jury in finding that it had adopted it as its own.

The defendant, however, claims that the contract was void under the statute of frauds, because, "by its terms not to be performed within one year from the making thereof," which counsel assumes to be September 12,—the date of the agreement between plaintiff and the promoter. This proceeds upon the erroneous theory that the act of the corporation, in such cases, is a ratification, which relates back to the date of the contract with the promoter, under the familiar maxim that "a subsequent ratification has a retroactive effect, and is equivalent to a prior command." But the liability of the corporation,

under such circumstances, does not rest upon any principle of the law of agency, but upon the immediate and voluntary act of the company. Although the acts of a corporation with reference to the contracts made by promoters in its behalf before its organization are frequently loosely termed "ratification," yet a ratification properly so called, implies an existing person, on whose behalf the contract might have been made at the time. There can not, in law, be a ratification of a contract which could not have been made binding on the ratifier at the time it was made, because the ratifier was not then in existence. In re Empress Engineering Co., 16 Ch. Div. 128; Melhado v. Porto Alegre, N. H. & B. R. Co., L. R. 9 C. P. 505; Kellner v. Baxter, L. R. 2 C. P. 185. What is called "adoption," in such cases, is, in legal effect, the making of a contract of the date of the adoption, and not as of some former date. The contract in this case was, therefore, not within the statute of frauds. The trial court fairly submitted to the jury all the issues of fact in this case, accompanied by instructions as to the law which were exactly in the line of the views we have expressed; and the evidence justified the verdict.

The point is made that the plaintiff should have alleged that the contract was made with Nimrocks, and subsequently adopted by the defendant. If we are correct in what we have said as to the legal effect of the adoption by the corporation of a contract made by a promoter in its behalf before its organization, the plaintiff properly pleaded the contract as having been made with the defendant. But we do not find that the evidence was objected to on the ground of a variance between it and the complaint. The assignments of error are very numerous, but what has been already said covers all that are entitled to any special notice.

Order affirmed.

CHAPTER V.

SUBSCRIBERS AND STOCK SUBSCRIPTIONS.

Subscriber Distinguished from Stockholder.

THRASHER v. THE PIKE COUNTY RAILROAD COMPANY.

25 Ill. 393. 1861.

Appeal from the circuit court of Pike county; the Hon. J. S. Bailey, judge, presiding.

This was an action of assumpsit by the Pike County Railroad Company against Charles Thrasher, upon the following agreement:

"We, the undersigned, agree to subscribe to the stock of the Pike County Railroad, the sum set against our names, when the books may be opened for subscription.

"Griggsville, March 19, 1856.

"Charles Thrasher.....$3,000"

BREESE, J., delivered the opinion of the court.

The appellee, who was plaintiff in the court below, urges several reasons justifying a recovery in this case, which it is necessary to notice. The declaration contains a special count, averring that on the 19th of March, 1856, the plaintiffs were a body politic and corporate with power to construct and operate a railroad within the county of Pike, and authorized by law, as such corporation, to secure subscriptions to the capital stock of the company to the amount of $1,000,000, in shares of $100 each, and, desiring to ascertain what amount of stock would be subscribed, and not having opened regular subscription books, but intending so to do, agreed with the defendant that they would, in a reasonable time thereafter, open books for the purpose of securing such subscriptions, and that they would permit and allow the defendant, when the book should be opened, to subscribe to the capital stock of the company thirty shares of $100 each, and upon payment therefor, the

defendant should be the owner of thirty shares of the capital stock of the company. It is then averred that the defendant, in consideration of this promise, undertook and promised the plaintiff that he would subscribe to the stock of this company the sum of $3,000 when the books should be opened for subscriptions; that this promise was by a writing, signed by the defendant, and by him delivered to the plaintiff. It is then averred, that on the same day subscription books to the capital stock of the company were opened, of which the defendant had notice. The breach is, that the defendant neglected and refused to subscribe anything to the capital stock, accompanied by an averment that the subscription, when the books were opened, was due and payable before the commencement of the suit, and although notified thereof, the defendant has refused to pay any part of the sum of the $3,000. The common counts are added, in one of which the indebtedness is alleged to be for 100 shares of the stock of the Pike County Railroad, before that time bargained and sold to the defendant.

This is the cause of action as set forth by the plaintiffs, and it is claimed by them that they are entitled to recover as damages the par value of the stock, or the amount of calls made from time to time upon it, and which, at the commencement of the suit, amounted to fourteen installments, of five per cent. each, making, in all, $2,100.

This, we do not think, is a fair view of the defendant's liability upon his promise, if one was made to the plaintiff. His undertaking is to subscribe a certain amount of stock when the subscription books should be opened. This promise does not make him a stockholder, and, as such, liable to calls. The company has parted with no stock to him, and can only claim as damages the actual loss sustained by them by his failure, or refusal to subscribe, when he was notified that the books were opened for such purpose. The company has the stock which the defendant promised to take, but did not take. His promise is like any other promise or agreement to purchase any specific article of property. If the property contracted be retained by the vendor, and there is no delivery to the purchaser, or offer to deliver, the damages must not be measured by the value of the property, for it would not be just, in such cases, that the

vendor should retain the property and recover also the value of it from the promisor. Some damage might result from the loss of a bargain, and to such the vendor would be entitled, if the extent could be established. In many cases they would be merely nominal. On an agreement for the sale and purchase of stocks, and a refusal by the purchaser to take the stocks, the measure of damages, ordinarily, might be the difference between the par value of the stocks and their market value, or between them and money. As well argued by the appellant, the defendant, having violated his promise by failing to subscribe, he has acquired no right to stock, nor could a recovery in this action entitle him to become a stockholder. The company retains its stock, and the defendant his money. A stock certificate of $3,000 would represent a value to the company equivalent to so much money, and, in a statement of their liabilities, this would appear against the company as so much held by the stockholders, for which the company was responsible. If there is no actual subscription, the company does not incur this liability. There being no special damage alleged, or proved, we do not think the plaintiffs could recover under this declaration, as they have done, the par value of the stock the defendant promised and agreed to take. A proper count might doubtless be so framed as to justify a full recovery under sufficient proof. * * *

Reversed.

Nature of Subscription Contract—Effect of Statutory Provisions.

COPPAGE, RECEIVER, v. HUTTON.

124 Ind. 401, 7 L. R. A. 591. 1890.

From the Montgomery circuit court.

ELLIOTT, J.—The appellant sues as the receiver of an insolvent corporation, and seeks to recover a subscription which he alleges the appellee made to the capital stock of the corporation. It is alleged that the appellee, with others, signed articles of association, and that he agreed to take two shares of the capital stock, and pay therefor $100. The introductory

clause of the articles of association reads thus: "We, the undersigned, agree to take the stock in the amount set opposite our names in a company to be organized for manufacturing and selling the Williamson Straw Stacker." There were eighty-three signers, and seven of them acknowledged the execution of the articles of association before a notary public, and the instrument was duly recorded. It is also alleged that $8,000 of stock was subscribed, that the company was duly organized and a board of directors elected.

There can be no doubt under the authorities that a valid subscription to the capital stock of a corporation may be made by signing the preliminary articles. Such a subscription becomes enforcible upon the perfection of the corporate organization according to the law under articles of association. Miller v. Wild Cat G. R. Co., 52 Ind. 51; Nulton v. Clayton, 54 Iowa 425; Phœnix, etc., Co. v. Badger, 67 N. Y. 294; Cravens v. Eagle, etc., Mills Co., 120 Ind. 6. If the promise of the appellee is not binding it must be for some other reason than that it was made before the organization of the corporation was fully effected.

The statute requires that the persons who desire to organize a corporation shall "make, sign and acknowledge, before some officer capable to take acknowledgment of deeds, a certificate in writing," setting forth therein certain enumerated things. Section 3851, R. S. 1881. The contention of the appellee is that the promise is not effective, because the complaint shows that only seven of the eighty-three signers acknowledged the certificate. It seems quite clear, under the decision of this court in Indianapolis, etc., Mining Co. v. Herkimer, 46 Ind. 142, that the mere signing of the paper was not sufficient to complete the obligation, and that, in order to make valid and effective articles of association against all who sign, all must acknowledge them as the statute requires. Here it affirmatively appears that seven only of the signers acknowledged the execution of the instrument, and it can not be inferred that those who did not acknowledge it remained bound by its terms. As to them the instrument was incomplete, and it is quite well settled that an incomplete subscription can not be enforced. Dutchess, etc., R. Co. v. Mabbett; 58 N. Y. 397; Reed v. Richmond, etc., R. Co., 50 Ind. 342; Richmond St. R.

Co. v. Reed, 83 Ind. 9; Williamson v. Kokomo, etc., Ass'n, 89 Ind. 389.

It is, however, argued by appellant's counsel that the complaint does affirmatively show that the corporation was organized, but this does not meet the question, for it may well be that it was organized without the appellee as a stockholder. The fact that he did not acknowledge the instrument as the law requires implies that he did not become a stockholder, and there is nothing in the complaint which rebuts or opposes this implication. It devolved upon the plaintiff to remove the inference if he could. As the appellee did not acknowledge the instrument as the law requires, he did not become a stockholder, and if he were insisting that he was entitled to the number of shares set opposite his name, it is quite clear that the corporation might successfully resist his claim, since it is obvious that only those who acknowledge the articles of association as the law requires can successfully insist upon their right to stock. If the appellee can not be regarded as a stockholder, then it seems quite clear that he did not bind himself by simply signing the articles of association.

Whether a good complaint can be framed is not the question before us, for the only question presented by the record is as to the sufficiency of the complaint as it is written.

Judgment affirmed.

Conditional Subscriptions.

BUTTERNUTS AND OXFORD TURNPIKE COMPANY v. NORTH.

1 Hill 518 (N. Y.). 1841.

Error from the Chenango common pleas. The action was upon a subscription for stock of the plaintiffs, containing an engagement to take stock "upon condition that said road shall be laid by Fayette village and Guildford Centre." The commissioners for receiving subscriptions had obtained several signatures to this, and also to another absolute in its terms. The court below held that the defendant's signature to the subscription in question did not bind him, and non-suited the

plaintiffs. They excepted, and after judgment in the court below, sued out a writ of error.

By the court, COWEN, J.—Subscriptions for stock under the turnpike act (1 R. S. 581, 2d ed.) to which the plaintiffs were subject, Sess. L. of 1834, p. 137, must be absolute. This act confers no power to make conditions, and to allow such a thing would be contrary to public policy. Divers men would, perhaps, have their divers routes, and endeavor improperly to influence the course of the road. If the general subscription should contain a condition of this kind, there would be no stockholders till the road should be laid out accordingly, and separate subscriptions containing various conditions might work a fraud upon those who subscribed absolutely. The court below decided correctly.

Judgment affirmed.

Effect of Change in Corporate Enterprise Upon Liability of Subscriber.

NORWICH LOCK MFG. CO. v. HOCKADAY.

89 Va. 557, 16 S. E. 877. 1893.

Error to judgment of the hustings court for the city of Roanoke, rendered March 14th, 1892, on a motion for judgment for money on contract, wherein the Norwich Lock Manufacturing Company, of Roanoke, Va., was plaintiff, and J. R. Hockaday was defendant. The judgment being adverse to the plaintiff company, it obtained a writ of error to this court. Opinion states the case.

FAUNTLEROY, J., delivered the opinion of the court.

The record discloses that about February 1st, 1891, a paper headed "A New and Important Industry for Roanoke" was circulated for signatures. It proceeds: "It is proposed to organize a company for the purpose of manufacturing locks, bolts, and all house hardware, and other articles of a similar character. The capital stock of the company will be from $350,000 to $400,000. An existing plant can be purchased at a proper valuation, and can be moved immediately to Roanoke.

It would, at Roanoke, have a decided advantage over its present location. There can be no question that securing this manufacturing plant for Roanoke will be the greatest step," etc.

The conclusion was: "We * * * hereby subscribe the amount set opposite our names, respectively, to the capital stock of the company to be formed in accordance with the provisions of the foregoing prospectus." * * * To this prospectus, or subscription-list, is subscribed the name of "J. R. Hockaday and others," (opposite) $1,500.

The entire amount subscribed to this paper was less than the proposed minimum of capital stock, and no company has been formed in accordance with the provisions of the aforesaid prospectus. Two months and more later, a paper, dated April 25th, 1861, was circulated for signatures, headed like the first, and proceeding: "An agreement has been made with a hardware manufactory in the North to sell its plant, etc. The stockholders of the company in the North have subscribed $200,000 to the company that is to be located on the property of the Roanoke Development Company, and the Roanoke Development Company has subscribed $75,000. The remaining $75,000 must be subscribed in order to secure the industry. The R. D. Company agree to donate a suitable site for the industry, for which full paid-up stock shall be issued: which stock the R. D. Co. agrees to donate to the company."

This prospectus paper concludes: "We, the undersigned, each, in consideration of the subscriptions of the others hereto, and the above agreement by the Roanoke Development Company, hereby subscribe the amount set opposite our names, respectively, to the capital stock of the company to be formed in accordance with the provisions of the foregoing prospectus," etc. The name of J. R. Hockaday, or "J. R. Hockaday and others," is not among the names of the subscribers to the capital stock under this subscription-list or prospectus; and the fact in the record is that J. R. Hockaday was approached and asked to subscribe under this second prospectus, and he positively and pointedly refused to subscribe, saying that it was a different contract and scheme from the first. Under this second prospectus the lock manufacturing plant was not to be located in or at Roanoke City (as it expressly

was in the first prospectus), but to be put beyond the city limits, on the opposite side of the river, and on the lands of the Roanoke Development Company, in the county of Roanoke, where its principal office was to be located. The charter under which the plaintiff company was organized was granted by the judge of the circuit court of Roanoke county May 21st, 1891, upon the presentation and provisions of a paper dated May 11th, 1891, and signed by Arthur C. Denniston, Edw. C. Pechin, Arthington Gilpin, S. W. Jamison and P. L. Terry, purporting to be their agreement to become a corporation by the name of the "Norwich Lock Manufacturing Company, of Roanoke, Virginia," for the purpose of manufacturing, dealing in, and selling locks, etc., and other articles of house hardware, and all other articles composed of iron, wood and other substances; of erecting and conducting all buildings and structures, and the machinery and appliances and fixtures incident thereto; of acquiring, holding and selling iron and other metals, wood and other substances; of acquiring and disposing of mineral and other lands in fee, timber and timber rights, water and water-power, and privileges, etc., as may be convenient for the business of the company; of erecting houses, etc., for the purposes of its business; of making and using all roads, etc., with power to borrow money, and create, issue and sell or dispose of its bonds, and to secure the same by deed of trust, etc. The minimum capital to be $350,000, the maximum $500,000. The county of Roanoke to be the place where the principal office of the company is to be kept.

The Norwich Lock Manufacturing Company, the plaintiff in this suit, which was organized, under the foregoing charter, August 4th, 1891, was not formed in accordance with the provisions of the prospectus or subscription paper on which the defendant, Hockaday, subscribed, but differs therefrom, radically and materiallly, in essential general object and purpose, as well as in special details, powers, and provisions.

The location, which was, by the subscription paper which the defendant, Hockaday, signed, in February, 1891, to be immediately placed in the city of Roanoke, is by the charter, and terms and agreement with the Roanoke Development Company, to be on the lands of that company, lying extensively on the opposite side of the Roanoke river, outside of the limits

of Roanoke City, and in the county of Roanoke. The maximum capital stock, which was to be $400,000, is, by the prospectus which Hockaday expressly refused to sign or to recognize, and by the charter under which the plaintiff company long subsequently organized, put at $500,000. And the purposes and powers of the company, as set forth in the prospectus and the charter under which they organized, are wholly and essentially different, embracing almost any and every industrial and speculative enterprise, whilst those specified and embraced in the prospectus or subscription signed by the defendant, Hockaday, and others, are, carefully and guardedly, expressly limited to the "purpose of manufacturing locks, bolts, and all house hardware, and other articles of a similar character."

The subscription-list which J. R. Hockaday and others signed in February, 1891, shows that the total amount of stock subscribed for, up to the day of the trial, was less, by $20,900, than the minimum capital stated in the prospectus or subscription contract signed by "Hockaday and others." There is no evidence in the record that the defendant, Hockaday, ever signed any but the subscription paper circulated in February, 1891; that he ever attended or heard of any meeting of stockholders, or paid any part of his conditional subscription, or expressly or impliedly promised to do so, or knew of or in any way acquiesced in the wide and material variances between the charter and the paper which he had signed; while it is explicitly in evidence that he refused to sign, or in any way recognize, the paper which was substituted therefor, and sued upon in this case.

After the evidence was all in, the court, on motion of the defendant, instructed the jury "that the contract of subscription signed by the defendant, and proven in this case, is conditional upon the due organization of a company under and by virtue of said contract, and in accordance with the provisions thereof; and that the Norwich Lock Manufacturing Company, of Roanoke, chartered by the Hon. Henry E. Blair, judge of the circuit court of Roanoke county, Virginia, and introduced in evidence, is not such a company as is contemplated by and provided for in said contract. That the contract of subscription by the defendant proven in this case is a con-

ditional one—conditioned upon the organization of a company under and in accordance with the provisions of the said contract; and if they believe, from the evidence, that the plaintiff company was not organized under said contract and in accordance therewith, they must find for the defendant."

The jury did find for the defendant, and the court refused to set the verdict aside, and entered judgment accordingly.

Upon the facts in the case we can conceive of no instructions more proper, and less calculated to mislead the jury, than those given in this case. It is indisputably the province and the duty of the court to construe and instruct the jury as to the legal effect of all written instruments which are the subject of the controversy and the bases of the suit; and the court only exercised its legitimate function in comparing the subscription paper and the charter of the company under which they organized, and telling the jury that the latter was not, in legal effect, in accordance with the provisions of the former; that the plaintiff, Norwich Lock Manufacturing Company, was not such a company, nor the company, contemplated by and provided for in the subscription contract signed by the defendant. The charter, and the prospectus under which they organized, and to which the defendant positively refused to accede or consent, differ from the mere subscription-list signed by the defendant, as to the location, the maximum capital, and the objects and scope of the enterprise; and the company proposed to be formed, to whose capital stock he conditionally subscribed, was never formed.

There is no question in this case of amendments to the charter, whether material or immaterial. The prospectus to which the defendant subscribed his name, conditionally, was substituted by another and a radically different prospectus (to which he refused to subscribe), and by agreement and arrangement between parties with whom he had no privity; and the substitution and changes made in the schemes and scope of the enterprise were made before the charter was granted or applied for. If, after one has signed a contract agreeing to form a corporation for a named purpose, such contract is changed in any way, before the incorporation, without such subscriber's consent, he is not bound, because the company formed is not the company he subscribed to. 1 Law-

son R. R. & P., sec. 441; Dorris v. Sweeney, 60 N. Y. 463; Dutchess, etc., v. Moffett, 58 N. Y. 397; Southern Hotel Co. v. Newman, 30 Mo. 118; Richmond Fac. Asso. v. Clarke, 61 Maine 351; Mohan v. Wood, 44 Cal. 462.

In 1 Lawson R. R. and P., section 435, p. 777, it is said: "One who signs a mere subscription paper, agreeing to take a number of shares in a corporation to be formed, is not liable therefor after the formation of the company," where the company is formed not in accordance with the provisions of the subscription paper. "One who signed, with others, a subscription paper, promising to take and pay for shares in a joint-stock association to build a hotel, most of which subscribers were afterwards incorporated, but the defendant was not one of them, is not bound, by his subscription, to pay for his shares to the corporation, there being no privity of contract." Machias Hotel Company v. Coyle, 58 Am. Dec. 712; Mount Sterling Coal-Yard Company v. Little, 16 Bush. 429.

As before said, there is no question in this case of amendments to charter; but, even after a corporation has been organized under its charter, its charter cannot be materially amended, to bind a stockholder, without his consent. To vary the route of a railroad, shortening the line, allowing business to be commenced before the full capital stock is subscribed, are instances of material changes which will release a stockholder. See note 1, sec. 500, p. 518, Cook on Corporations. To superadd a new and different business to the original undertaking will work a dissolution of the contract. Clearwater v. Meredith, 1 Wall. 40.

In Fry's Executor v. Lexington & Co., 2 Metcalf (Ky.) 314, the court said. "Each stockholder has a right to insist on the prosecution of the particular objects of the charter." The stockholder may say: "I have agreed to become interested, and have contracted, in view of the profits expected, and the perils and losses incident to that description of business; but I have not agreed that those to be intrusted with the capital I contributed shall have power to use it in a business of a different character, and attended with hazards of a different description." Marietta, etc., R. R. Co. v. Elliott, 10 Ohio St. Rep. 57 (1859); Ashton v. Burbank, 2 Dill. 435 (1873).

There is no evidence, or even a contention, that the defend-

ant ever signed any subscription paper but the prospectus or subscription-list No. 1, in February, 1891, which was abandoned and substituted by the prospectus and agreement dated May 11th, 1891; that he ever attended or heard of any meeting of stockholders, or paid any part of his alleged subscription, or expressly or impliedly promised to do so, or in any way acquiesced in the variances between the charter and the paper he had signed; but there is undenied evidence that he positively refused to sign the paper which was substituted therefor. And the record plainly shows that there was in evidence before the jury the all-sufficient defense against the plaintiff's claim—viz., that, up to the trial, the plaintiff company had failed to obtain subscriptions to the extent of even its minimum of capital stock; and, therefore, it could not lawfully hold the defendant liable for his mere conditional subscription, even though the scheme and scope of the business proposed in the first prospectus had not been radically and essentially changed and enlarged by the second and substituted prospectus, to which defendant was not a party or privy. Cook on Corp., sec. 176, says: "It is an implied part of a contract of subscription that the contract is to be binding and enforceable against the subscriber only after the full capital stock of the corporation has been subscribed." He cannot be even liable to assessment unless and until the proposed capital stock of the company has been fully subscribed, unless there is a contrary provision in the article, or in the general law under which the corporation is formed. 1 Lawson R. R. and P., sec. 439, p. 733; Morawetz on Corp., sec. 259.

The rule of the Code of 1887, sec. 3484, applied to the evidence certified in this record, requires that the verdict of the jury, which is fully warranted by the facts and the law, and the judgment of the court thereon, should be affirmed.

Judgment affirmed.

CHAPTER VI.

THE CORPORATION AND THE STATE.

The Franchise to Be a Corporation.

FIETSAM v. HAY.

122 Ill. 293, 13 N. E. 501, 3 Am. St. R. 492. 1887.

Appeal from the circuit court of St. Clair county.

MULKEY, J., delivered the opinion of the court.

The People's Bank of Belleville, incorporated under a special act of legislature, approved and in force March 27, 1869, having become insolvent on the 17th of April, 1878, made a general assignment of all its property and effects for the benefit of creditors. The assignee presented a petition to the county court of St. Clair county, at its March term, 1887, for leave to sell "all the rights, privileges, powers and immunities which were granted by the said act incorporating said bank." The judge of the county court being interested in the result of the proceeding, the venue was changed to the circuit court of St. Clair county, where, upon due consideration of the petition, that court entered an order dismissing the same. The present appeal is from the order of dismissal.

The correctness of the decision of the circuit court depends entirely upon whether the title of the franchise created and conferred by the bank charter passed as an asset of the bank, to the assignee, under the assignment. That its language is sufficiently comprehensive, and adequate to pass the franchise to the assignee, if, as matter of law, the bank could transfer it at all, we have no doubt. This is not questioned. The question, therefore, is whether a corporate franchise, in the absence of statutory authority, is in law capable of being assigned or transferred. Differently put, the question, as formulated by the parties themselves, is, "did the franchise of the said bank pass with the deed of assignment to the assignee as a salable asset of the said bank?"

The word "franchise" is often used in the sense of privileges generally, but in its more appropriate and legal sense the term is confined to such rights and privileges as are conferred upon corporate bodies by legislative grant. It is in the latter sense, alone, the word is now to be considered.

The franchise proposed to be sold is a corporate franchise, and the artificial body or political entity to which it pertains is what is known to the law as an aggregate corporation. Such a corporation has been well defined to be "an artificial being created by law, and composed of individuals who subsist as a body politic under a special denomination, with the capacity of perpetual succession, and of acting, within the scope of its charter, as a natural person." Now, a franchise is nothing more than the right or privilege of being a corporation, and of doing such things, and such things only, as are authorized by the corporation's charter. This right of a body of men to be and act as an artificial person, without, as a general rule, incurring individual responsibility, is declared by Blackstone to be "a royal privilege, or branch of the king's prerogative, subsisting in the hands of a subject." (2 Blackstone, 37.) Such right or franchise is defined by Bouvier to be "a certain privilege conferred by grant from government, and vested in individuals." (1 Bouvier, 545.) Now, it is clear from these definitions, and from the very nature of a corporation, that a franchise or the right to be and act as an artificial body, vests in the individuals who compose the corporation, and not in the corporation itself. This fact, we think, is not without significance in reaching a conclusion upon the main question to be determined, outside of the numerous authorities bearing directly on the subject.

It will be kept in mind that the corporate body, for purposes of ownership, and, indeed, for most purposes, has a distinct identity from that of the individual corporators. The latter may be wealthy, when at the same time the former is insolvent, and vice versa. The corporation has no right to appropriate, sell or otherwise dispose of any of the property or effects of a corporator. The relation of debtor and creditor may subsist between them in the same manner as between the company and other persons. The company's entire property may be swept away from it by sequestration, or other means, and

yet its franchises will remain vested in the corporators, until they are either abandoned or forfeited to the state. All these propositions are familiar to the courts and the profession, and are all well sustained by authority.

If, then, the franchise is vested in and belongs to the corporators, and not to the corporation itself, how could the latter transfer or assign it to another? On the plainest of principles this could not be done without legislative authority for that purpose, and we find nothing, either in the statute or the company's charter, conferring such authority. While it is conceded the legislature might confer on the artificial body the power to sell or assign the franchise to strangers, yet this would be, in effect, to authorize it to commit a species of suicide, for it is manifest the corporation could not exist a moment after the franchise conferred upon its members had been transferred to others. Indeed, when we consider the attributes and essential elements of corporate existence, resulting from the grant of the franchise, and without which the artificial body could not accomplish the objects of its creation or perform the duties imposed upon it by law, the sale or assignment of the franchise without special legislative authority would seem to be wholly inadmissible. It is proposed here, it will be noted, to sell simply the franchise of the bank. Assuming this can be done, the question arises what would be the effect of such a sale? It clearly could not have the effect of making the purchasers, if more than one, an aggregate corporation, with the general banking powers conferred by the bank charter. To assert such a proposition would be simply startling; and yet, if in such case the purchasers would take anything at all, they certainly could not take less than the right to be a banking corporation, with all the powers and privileges conferred by the charter, for these rights are of the very essence of the franchise; and consequently the one could not be thus acquired without, by the same act, securing the others—a view which, as already indicated, has no sanction in reason or authority.

While statements are to be found on this subject in some of the text-books, as well as in some of the decided cases, which can not be reconciled with the conclusion we have reached, yet we are clearly of opinion that a corporation, in

the absence of statutory authority, has no right to sell or transfer its franchise or any property essential to its exercise, which it has acquired under the law of eminent domain. This proposition, in our judgment, is sustained both by reason and the decided weight of authority. Black et al. v. Delaware and Raritan Canal Co., 24 N. J. Eq. 455; Freeman on Executions, §§ 179, 180; Pearce on Railroads, 496-1; Jones on Mortgages, § 161; Rorer on Judicial Sales (2d ed.), 222; Archer v. Terre Haute and Indianapolis R. Co., 102 Ill. 493; Bruffett v. Great Western R. Co., 25 Ill. 353; Chicago and Rock Island R. Co. v. Whipple, 22 Ill. 105; Ottawa, Oswego and Fox River Valley R. Co. v. Black, 79 Ill. 262.

The circuit court having reached this conclusion, its order and judgment will be affirmed.

Judgment affirmed.

Tax on Capital Stock and Shares of Stock.

COOK v. CITY OF BURLINGTON.

59 Iowa 251. 1882.

The plaintiffs are the executors of the estate of James W. Grimes, deceased. They are residents of the city of Burlington, where the estate is situated. Part of the estate consists of shares of stock in the Dunleith and Dubuque Bridge Co., which is a corporation of that name, incorporated under the general incorporation laws of the State of Iowa, and having its principal place of business in Dubuque county. The corporation owns a bridge across the Mississippi river, from the city of Dubuque, Iowa, to the eastern shore of the river in the State of Illinois, and said bridge is all the tangible property owned by the corporation. The bridge was assessed for taxation at Dubuque, and the taxes were paid. The shares of stock in the bridge company held and owned by the estate of Grimes were also assessed for taxation for the same year at the city of Burlington. The plaintiffs claimed that the stock was not liable to taxation, and appealed from the board of equalization of the city of Burlington to the circuit court. Upon a trial in the circuit court, it was held that the assessment of the stock was authorized by law, and plaintiffs appeal.

ROTHROCK, J.—The assessment of the bridge as the property of the corporation was authorized by law. Appeal of The Des Moines Water Company, 48 Iowa 324. Whether the shares of stock can be legally assessed and taxed as the property of the stockholders for the same year for which the property of the corporation is assessed and taxed was not determined in that case. It was said, however, that "the statute provides that the stock of such corporations shall be assessed at its cash value. When assessed and taxed under the statute, stock must be taxed as the property of the respective owners, and there is no provision making the corporation liable therefor."

We have then the question in this case whether the shares of stock may be taxed in addition to the taxation of the property of the corporation.

And we may say, once for all, at the outset, that our views, as expressed in the case just cited, that the statute provides that the stock shall be assessed and taxed, remains unchanged. This conclusion is not founded upon any doubtful construction of the statute, but upon its plain, certain and unequivocal language and meaning. The statute imposing this burden upon the stock is found in section 813 of the Code, and is as follows: "Depreciated bank notes and the stock of corporations and companies shall be assessed at their cash value, * * * "

It is idle to contend in the face of this plain and explicit language that the legislature has not required that stock in corporations shall be assessed, and the only question now for determination is, does the legislature have the power to determine that the property of a corporation and the stock shall both be taxed.

Counsel for appellants contend that no such power exists, because it is duplicate or double taxation of the same property, and it is insisted that "this court has over and over again declared that double taxation is forbidden by our Constitution." If this statement were correct, and we should concede that the question here presented were one of duplicate taxation, the case could easily and speedily be disposed of by a prompt reversal. But, while it is true that this court in Tallman v. Butler County, 12 Iowa 534, said that it "is neither the policy nor the justice of the law to tolerate double taxation," and

in U. S. Express Co. v. Ellyson, 28 Id. 378, that "double taxation would be so unjust as to excite disfavor of both courts and legislature," and in McGregor's Executors v. Vanpel, 24 Id. 436, that mortgages upon real estate should be held to be taxable "unless this will lead to double taxation," yet it never has been held in this state, that what is denominated duplicate taxation is in excess of the legislative power. The most that can be said of these utterances of this court is, that it should be held in disfavor by courts and legislatures. * * *

It must be conceded that the taxation of the property of the corporation and also of the stock bears no resemblance to taxing the same tract of land twice to the same person, nor once to A, and again to B. That would be a double taxation, which we suppose would not be allowable in any state in the union. It would be a direct discrimination and inequality in the exercise of the taxing power, which would impose a greater burden upon one citizen than upon another upon the same kind of property. But the case at bar is quite different. The corporation is a person distinct from the stockholder. It is true, it is what is denominated an artificial person, and may be said to be ideal and intangible. But that it is a person in law is the first principle learned by the student in opening any book on corporations. Its stockholders are distinct and different persons. They are usually not liable for its debts, and have no right to the enjoyment or possession of its property during the period of its duration or until it be dissolved by some procedure known to the law. The stockholder is entitled to dividends upon his stock, if there be any dividends, and the value of his stock depends upon prospective dividends, and the dividends depend upon the net earnings of the corporation. If the bridge in this case be taxed, the tax must be paid from the income, and this reduces the value of the stock, so that there is no duplicate taxation, so far at least as the tax upon the bridge reduces the value of the stock. * * *

In the case at bar the stockholders paid to the corporation a certain sum of money. The corporation used this money in the construction of a toll-bridge from which the corporation derived an income. The agreement between the contracting parties is that the corporation is to manage and control the bridge, make the necessary repairs, and pay the taxes assessed

against the bridge, and after deducting these legitimate and necessary expenses pay to the stockholder his proportionate share of the net earnings, and upon the dissolution of the corporation the stockholder is to be repaid his money advanced from the property belonging to the dead corporation. Now, suppose this very contract were made with a natural person instead of a corporation, and the stockholder or creditor should make a claim that the obligation held by him was not taxable. There would be no more grounds for such claim under our system of taxation than there would be for the claim that if A loans B $100, which is invested in merchandise, the debt is not taxable because the merchandise is taxable.

These illustrations, it appears to us, demonstrate that if we were to determine that the legislature has no constitutional power to impose this tax upon the stockholder, it would open a door into a sea of trouble in the administration of the revenue laws of the state.

In disposing of this important question we have not reviewed the authorities cited by the respective counsel of the parties. It is sufficient to say that these views are supported by the very great majority of adjudged cases upon this subject. We think the circuit court correctly determined that the shares of stock are taxable. * * *

Affirmed.

ADAMS, J.—I concur in the result reached in this case, but not in the ground upon which it is reached. * * * The majority hold that such taxation would not be double taxation in such sense that it is not allowable. Upon this question, I do not feel called upon to express any opinion.

The Charter as a Contract.

TRUSTEES OF DARTMOUTH COLLEGE v. WOODWARD.

4 Wheaton 518 (U. S.) 1819.

MARSHALL, C. J.—This is an action of trover, brought by the trustees of Dartmouth College against William H. Woodward, in the State Court of New Hampshire, for the books of

records, corporate seal, and other corporate property, to which the plaintiffs allege themselves to be entitled.

A special verdict, after setting out the rights of the parties, finds for the defendant, if certain acts of the legislature of New Hampshire, passed on the 27th of June and on the 18th of December, 1816, be valid and binding on the trustees without their assent, and not repugnant to the constitution of the United States; otherwise, it finds for the plaintiffs.

The Superior Court of Judicature of New Hampshire rendered a judgment upon this verdict for the defendant, which judgment has been brought before this court by writ of error. The single question now to be considered is, do the acts to which the verdict refers violate the constitution of the United States?

This court can be insensible neither to the magnitude nor delicacy of this question. The validity of a legislative act is to be examined, and the opinion of the highest law tribunal of a state is to be revised; an opinion which carries with it intrinsic evidence of the diligence, of the ability and the integrity with which it was formed. On more than one occasion this court has expressed the cautious circumspection with which it approaches the consideration of such questions, and has declared that in no doubtful case would it pronounce a legislative act to be contrary to the constitution. But the American people have said, in the constitution of the United States, that "no state shall pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts." In the same instrument they have also said "that the judicial power shall extend to all cases in law and equity arising under the constitution." On the judges of this court, then, is imposed the high and solemn duty of protecting, from even legislative violation, those contracts which the constitution of our country has placed beyond legislative control, and, however irksome the task may be, this is a duty from which we dare not shrink.

The title of the plaintiffs originates in a charter dated the 13th day of December, in the year 1769, incorporating twelve persons therein mentioned, by the name of "The Trustees of Dartmouth College," granting to them and their successors the usual corporate privileges and powers, and authorizing the

trustees, who are to govern the college, to fill up all vacancies which may be created in their own body.

The defendant claims under three acts of the legislature of New Hampshire, the most material of which was passed on the 27th of June, 1816, and is entitled "An act to amend the charter, and enlarge and improve the corporation of Dartmouth College." Among other alterations in the charter, this act increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, with power to inspect and control the most important acts of the trustees. The board consists of twenty-five persons. The president of the senate, the speaker of the house of representatives, of New Hampshire, and the governor and lieutenant-governor of Vermont, for the time being, are to be members ex-officio. The board is to be completed by the governor and council of New Hampshire, who are also empowered to fill all vacancies which may occur. The acts of the 18th and 26th of December are supplemental to that of the 27th of June, and are principally intended to carry that act into effect.

The majority of the trustees of the college have refused to accept this amended charter, and have brought this suit for the corporate property, which is in possession of a person holding by virtue of the acts which have been stated.

It can require no argument to prove that the circumstances of this case constitute a contract. An application is made to the crown for a charter to incorporate a religious and literary institution. In the application it is stated that large contributions have been made for the object, which will be conferred on the corporation as soon as it shall be created. The charter is granted, and on its faith the property is conveyed. Surely in this transaction every ingredient of a complete and legitimate contract is to be found.

The points for consideration are:

1. Is this contract protected by the constitution of the United States?

2. Is it impaired by the acts under which the defendant holds?

1. On the first point it has been argued that the word "contract," in its broadest sense, would comprehend the

political relations between the government and its citizens, would extend to offices held within a state for state purposes, and to many of those laws concerning civil institutions which must change with circumstances and be modified by ordinary legislation; which deeply concern the public, and which, to preserve good government, the public judgment must control; that even marriage is a contract, and its obligations are affected by the laws respecting divorces; that the clause in the constitution, if construed in its greatest latitude, would prohibit these laws. Taken in its broad, unlimited sense, the clause would be an unprofitable and vexatious interference with the internal concerns of a state, would unnecessarily and unwisely embarrass its legislation, and render immutable those civil institutions which are established for purposes of internal government, and which, to subserve those purposes, ought to vary with varying circumstances. That as the framers of the constitution could never have intended to insert in that instrument a provision so unnecessary, so mischievous, and so repugnant to its general spirit, the term "contract" must be understood in a more limited sense. That it must be understood as intended to guard against a power of at least doubtful utility, the abuse of which had been extensively felt, and to restrain the legislature in future from violating the right to property. That anterior to the formation of the constitution a course of legislation had prevailed in many, if not in all, of the states, which weakened the confidence of man in man and embarrassed all transactions between individuals by dispensing with a faithful performance of engagements. To correct this mischief, by restraining the power which produced it, the state legislatures were forbidden "to pass any law impairing the obligation of contracts," that is, of contracts respecting property, under which some individual could claim a right to something beneficial to himself; and that, since the clause in the constitution must in construction receive some limitation, it may be confined, and ought to be confined, to cases of this description; to cases within the mischief it was intended to remedy.

The general correctness of these observations cannot be controverted. That the framers of the constitution did not intend to restrain the states in the regulation of their civil institu-

tions, adopted for internal government, and that the instrument they have given us is not to be so construed, may be admitted. The provision of the constitution never has been understood to embrace other contracts than those which respect property, or some object of value, and confer rights which may be asserted in a court of justice. It never has been understood to restrict the general right of the legislature to legislate on the subject of divorces. Those acts enable some tribunals, not to impair a marriage contract, but to liberate one of the parties because it has been broken by the other. When any state legislature shall pass an act annulling all marriage contracts, or allowing either party to annul it without the consent of the other, it will be time enough to inquire whether such an act be constitutional.

The parties in this case differ less on general principles, less on the true construction of the constitution in the abstract, than on the application of those principles to this case, and on the true construction of the charter of 1769. This is the point on which the cause essentially depends. If the act of incorporation be a giant of political power, if it create a civil institution to be employed in the administration of the government, or if the funds of the college be public property, or if the state of New Hampshire, as a government, be alone interested in its transactions, the subject is one in which the legislature of the state may act according to its own judgment, unrestrained by any limitation of its power imposed by the constitution of the United States.

But if this be a private eleemosynary institution, endowed with a capacity to take property for objects unconnected with government, whose funds are bestowed by individuals on the faith of the charter; if the donors have stipulated for the future disposition and management of those funds in the manner prescribed by themselves, there may be more difficulty in the case, although neither the persons who have made these stipulations nor those for whose benefit they were made should be parties to the cause. Those who are no longer interested in the property may yet retain such an interest in the preservation of their own arrangements as to have a right to insist that those arrangements shall be held sacred. Or, if they have themselves disappeared, it becomes a subject of serious

and anxious inquiry whether those whom they have legally empowered to represent them forever may not assert all the rights which they possessed while in being; whether, if they be without personal representatives who may feel injured by a violation of the compact, the trustees be not so completely their representatives, in the eye of the law, as to stand in their place, not only as respects the government of the college, but also as respects the maintenance of the college charter.

It becomes, then, the duty of the court most seriously to examine this charter, and to ascertain its true character.

From the instrument itself it appears that about the year 1754 the Rev. Eleazar Wheelock established, at his own expense and on his own estate, a charity school for the instruction of Indians in the Christian religion. The success of this institution inspired him with the design of soliciting contributions in England for carrying on and extending his undertaking. In this pious work he employed the Rev. Nathaniel Whitaker, who, by virtue of a power of attorney from Dr. Wheelock, appointed the Earl of Dartmouth and others trustees of the money which had been, and should be, contributed, which appointment Dr. Wheelock confirmed by a deed of trust authorizing the trustees to fix on a site for the college. They determined to establish the school on Connecticut river, in the western part of New Hampshire, that situation being supposed favorable for carrying on the original design among the Indians, and also for promoting learning among the English; and the proprietors in the neighborhood having made large offers of land on condition that the college should there be placed. Dr. Wheelock then applied to the crown for an act of incorporation, and represented the expediency of appointing those whom he had, by his last will, named as trustees in America, to be members of the proposed corporation. "In consideration of the premises," "for the education and instruction of the youth of the Indian tribes," etc., "and also of English youth and any others," the charter was granted, and the trustees of Dartmouth College were by that name created a body corporate, with power, for the use of the said college, to acquire real and personal property, and to pay the president, tutors and other officers of the college such salaries as they shall allow.

The charter proceeds to appoint Eleazar Wheelock, "the founder of said college," president thereof, with power by his last will to appoint a successor, who is to continue in office until disapproved by the trustees. In case of vacancy the trustees may appoint a president, and in case of the ceasing of a president the senior professor or tutor, being one of the trustees, shall exercise the office until an appointment shall be made. The trustees have power to appoint and displace professors, tutors, and other officers, and to supply any vacancies which may be created in their own body by death, resignation, removal, or disability; and also to make orders, ordinances and laws for the government of the college, the same not being repugnant to the laws of Great Britain or of New Hampshire, and not excluding any person on account of his speculative sentiments in religion, or his being of a religious profession different from that of the trustees.

This charter was accepted, and the property, both real and personal, which had been contributed for the benefit of the college, was conveyed to, and vested in, the corporate body.

From this brief review of the most essential parts of the charter it is apparent that the funds of the college consisted entirely of private donations. It is, perhaps, not very important who were the donors. The probability is that the Earl of Dartmouth and the other trustees in England were, in fact, the largest contributors. Yet the legal conclusion from the facts recited in the charter would probably be that Dr. Wheelock was the founder of the college.

The origin of the institution was, undoubtedly, the Indian charity school established by Dr. Wheelock, at his own expense. It was at his instance, and to enlarge this school, that contributions were solicited in England. The person soliciting these contributions was his agent, and the trustees, who received the money, were appointed by, and act under, his authority. It is not too much to say that the funds were obtained by him, in trust, to be applied by him to the purposes of his enlarged school. The charter of incorporation was granted at his instance. The persons named by him in his last will, as the trustees of his charity school, compose a part of the corporation, and he is declared to be the founder of the college, and its president for life. Were the inquiry material, we

should feel some hesitation in saying that Dr. Wheelock was not, in law, to be considered as the founder (1 Bl. Com. 481) of this institution, and as possessing all the rights appertaining to that character. But be this as it may, Dartmouth College is really endowed by private individuals, who have bestowed their funds for the propagation of the Christian religion among the Indians, and for the promotion of piety and learning generally. From these funds the salaries of the tutors are drawn, and these salaries lessen the expense of education to the students. It is, then, an eleemosynary (1 Bl. Com. 471), and, so far as respects its funds, a private corporation.

Do its objects stamp on it a different character? Are the trustees and professors public officers, invested with any portion of political power, partaking in any degree in the administration of civil government, and performing duties which flow from the sovereign authority?

That education is an object of national concern, and a proper subject of legislation, all admit. That there may be an institution founded by government, and placed entirely under its immediate control, the officers of which would be public officers, amenable exclusively to government, none will deny. But is Dartmouth College such an institution? Is education altogether in the hands of government? Does every teacher of youth become a public officer, and do donations for the purpose of education necessarily become public property, so far that the will of the legislature, not the will of the donor, becomes the law of the donation? These questions are of serious moment to society, and deserve to be well considered.

Dr. Wheelock, as the keeper of his charity school, instructing the Indians in the art of reading, and in our holy religion, sustaining them at his own expense, and on the voluntary contributions of the charitable, could scarcely be considered as a public officer, exercising any portion of those duties which belong to government; nor could the legislature have supposed that his private funds, or those given by others, were subject to legislative management, because they were applied to the purposes of education. When, afterwards, his school was enlarged, and the liberal contributions made in England and in America enabled him to extend his cares to the education of

the youth of his own country, no change was wrought in his own character or in the nature of his duties. Had he employed assistant tutors with the funds contributed by others, or had the trustees in England established a school with Dr. Wheelock at its head, and paid salaries to him and his assistants, they would still have been private tutors, and the fact that they were employed in the education of youth could not have converted them into public officers, concerned in the administration of public duties, or have given the legislature a right to interfere in the management of the fund. The trustees, in whose care that fund was placed by the contributors, would have been permitted to execute their trust uncontrolled by legislative authority.

Whence, then, can be derived the idea that Dartmouth College has become a public institution, and its trustees public officers, exercising powers conferred by the public for public objects? Not from the source whence its funds were drawn, for its foundation is purely private and eleemosynary. Not from the application of those funds, for money may be given for education, and the persons receiving it do not, by being employed in the education of youth, become members of the civil government. Is it from the act of incorporation? Let this subject be considered.

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities that corporations were invented, and are in use. By these means a perpetual succession of individuals are capa-

ble of acting for the promotion of the particular object, like one immortal being. But this being does not share in the civil government of the country, unless that be the purpose for which it was created. Its immortality no more confers on it political power, or a political character, than immortality would confer such power or character on a natural person. It is no more a state instrument than a natural person exercising the same powers would be. If, then, a natural person, employed by individuals in the education of youth, for the government of a seminary in which youth is educated, would not become a public officer, or be considered as a member of the civil government, how is it that this artificial being, created by law for the purpose of being employed by the same individuals for the same purposes, should become a part of the civil government of the country? Is it because its existence, its capacities, its powers, are given by law? Because the government has given it the power to take and to hold property in a particular form, and for particular purposes, has the government a consequent right substantially to change that form, or to vary the purposes to which the property is to be applied? This principle has never been asserted or recognized, and is supported by no authority. Can it derive aid from reason?

The objects for which a corporation is created are universally such as the government wishes to promote. They are deemed beneficial to the country, and this benefit constitutes the consideration, and, in most cases, the sole consideration of the grant. In most eleemosynary institutions the object would be difficult, perhaps unattainable, without the aid of a charter of incorporation. Charitable or public spirited individuals, desirous of making permanent appropriations for charitable or other useful purposes, find it impossible to effect their design securely, and certainly, without an incorporating act. They apply to the government, state their beneficent object, and offer to advance the money necessary for its accomplishment, provided the government will confer on the instrument which is to execute their designs the capacity to execute them. The proposition is considered and approved. The benefit to the public is considered as an ample compensation for the faculty it confers, and the corporation is created. If

the advantages to the public constitute a full compensation for the faculty it gives, there can be no reason for exacting a further compensation by claiming a right to exercise over this artificial being a power which changes its nature, and touches the fund, for the security and application of which it was created. There can be no reason for implying in a charter, given for a valuable consideration, a power which is not only not expressed, but is in direct contradiction to its express stipulations.

From the fact, then, that a charter of incorporation has been granted, nothing can be inferred which changes the character of the institution, or transfers to the government any new power over it. The character of civil institutions does not grow out of their incorporation, but out of the manner in which they are formed, and the objects for which they are created. The right to change them is not founded on their being incorporated, but on their being the instruments of government, created for its purpose. The same institutions, created for the same objects, though not incorporated, would be public institutions, and, of course, be controllable by the legislature. The incorporating act neither gives nor prevents this control. Neither, in reason can the incorporating act change the character of a private eleemosynary institution.

We are next led to the inquiry, for whose benefit the property given to Dartmouth College was secured. The counsel for the defendant have insisted that the beneficial interest is in the people of New Hampshire. The charter, after reciting the preliminary measures which had been taken, and the application for an act of incorporation, proceeds thus: "Know ye, therefore, that we, considering the premises, and being willing to encourage the laudable and charitable design of spreading Christian knowledge among the savages of our American wilderness, and, also, that the best means of education be established, in our province of New Hampshire, for the benefit of said province, do, of our special grace," etc. Do these expressions bestow on New Hampshire any exclusive right to the property of the college and exclusive interest in the labors of the professors? Or do they merely indicate a willingness that New Hampshire should enjoy those advantages which

result to all from the establishment of a seminary of learning in the neighborhood? On this point we think it impossible to entertain a serious doubt. The words themselves, unexplained by the context, indicate that the "benefit intended for the province" is that which is derived from "establishing the best means of education therein"; that is, from establishing in the province Dartmouth College, as constituted by the charter. But, if these words, considered alone, could admit of doubt, that doubt is completely removed by an inspection of the entire instrument.

The particular interest of New Hampshire never entered into the mind of the donors, never constituted a motive for their donation. The propagation of the Christian religion among the savages, and the dissemination of useful knowledge among the youth of the country, were the avowed and the sole objects of their contributions. In these New Hampshire would participate; but nothing particular or exclusive was intended for her. Even the site of the college was selected, not for the sake of New Hampshire, but because it was "most subservient to the great ends in view," and because liberal donations of land were offered by the proprietors on condition that the institution should be there established.

The real advantages from the location of the college are, perhaps, not less considerable to those on the west than to those on the east side of the Connecticut river. The clause which constitutes the incorporation, and expresses the objects for which it was made, declares those objects to be the instruction of the Indians, "and also of English youth, and any others." So that the objects of the contributors and the incorporating act were the same; the promotion of Christianity and of education generally, not the interests of New Hampshire particularly.

From this review of the charter it appears that Dartmouth College is an eleemosynary institution, incorporated for the purpose of perpetuating the application of the bounty of the donors to the specified objects of that bounty; that its trustees or governors were originally named by the founder, and invested with the power of perpetuating themselves; that they are not public officers, nor is it a civil institution, participating in the administration of government; but a charity school, or a seminary of education, incorporated for the preservation of

its property, and the perpetual application of that property to the objects of its creation.

Yet a question remains to be considered, of more real difficulty, on which more doubt has been entertained than on all that have been discussed. The founders of the college, at least those whose contributions were in money, have parted with the property bestowed upon it, and their representatives have no interest in that property. The donors of land are equally without interest so long as the corporation shall exist. Could they be found, they are unaffected by any alteration in its constitution, and probably regardless of its form, or even of its existence. The students are fluctuating, and no individual among our youth has a vested interest in the institution which can be asserted in a court of justice. Neither the founders of the college nor the youth for whose benefit it was founded complain of the alteration made in its charter, or think themselves injured by it. The trustees alone complain, and the trustees have no beneficial interest to be protected. Can this be such a contract as the constitution intended to withdraw from the power of state legislation? Contracts, the parties to which have a vested beneficial interest, and those only, it has been said, are the objects about which the constitution is solicitious, and to which its protection is extended.

The court has bestowed on this argument the most deliberate consideration, and the result will be stated. Dr. Wheelock, acting for himself, and for those who, at his solicitation, had made contributions to his school, applied for this charter, as the instrument which should enable him, and them, to perpetuate their beneficent intention. It was granted. An artificial, immortal being was created by the crown, capable of receiving and distributing forever, according to the will of the donors, the donations which should be made to it. On this being the contributions which had been collected were immediately bestowed. These gifts were made, not, indeed, to make a profit, for the donors or their posterity, but for something in their opinion of inestimable value; for something which they deemed a full equivalent for the money with which it was purchased. The consideration for which they stipulated is the perpetual application of the fund to its object, in the mode prescribed by themselves. Their de-

descendants may take no interest in the preservation of this consideration. But in this respect their descendants are not their representatives. They are represented by the corporation. The corporation is the assignee of their rights, stands in their place, and distributes their bounty as they would themselves have distributed it had they been immortal. So with respect to the students who are to derive learning from this source. The corporation is a trustee for them also. Their potential rights, which, taken distributively, are imperceptible, amount collectively to a most important interest. These are, in the aggregate, to be exercised, asserted, and protected by the corporation. They were as completely out of the donors at the instant of their being vested in the corporation, and as incapable of being asserted by the students, as at present.

According to the theory of the British constitution, their parliament is omnipotent. To annul corporate rights might give a shock to public opinion, which that government has chosen to avoid, but its power is not questioned. Had parliament, immediately after the emanation of this charter, and the execution of those conveyances which followed it, annulled the instrument, so that the living donors would have witnessed the disappointment of their hopes, the perfidy of the transaction would have been universally acknowledged. Yet then, as now, the donors would have had no interest in the property; then, as now, those who might be students would have had no rights to be violated; then, as now, it might be said that the trustees, in whom the rights of all were combined, possessed no private, individual, beneficial interest in the property confided to their protection. Yet the contract would at that time have been deemed sacred by all. What has since occurred to strip it of its inviolability? Circumstances have not changed it. In reason, in justice, and in the law it is now what it was in 1769.

This is plainly a contract to which the donors, the trustees, and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract made on a valuable consideration. It is a contract for the security and disposition of property. It is a contract on the faith of which real and personal estate has been conveyed to the corporation. It is then a contract within the letter of the

constitution, and within its spirit also, unless the fact that the property is invested by the donors in trustees for the promotion of religion and education, for the benefit of persons who are perpetually changing, though the objects remain the same, shall create a particular exception, taking this case out of the prohibition contained in the constitution.

It is more than possible that the preservation of rights of this description was not particularly in the view of the framers of the constitution when the clause under consideration was introduced into that instrument. It is probable that interferences of more frequent recurrence, to which the temptation was stronger, and of which the mischief was more extensive, constituted the great motive for imposing this restriction on the state legislatures. But although a particular and a rare case may not, in itself, be of sufficient magnitude to induce a rule, yet it must be governed by the rule, when established, unless some plain and strong reason for excluding it can be given. It is not enough to say that this particular case was not in the mind of the convention when the article was framed, nor of the American people when it was adopted. It is necessary to go farther, and to say that, had this particular case been suggested, the language would have been so varied as to exclude it, or it would have been made a special exception. The case being within the words of the rule, must be within its operation likewise, unless there be something in the literal construction so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument, as to justify those who expound the constitution in making it an exception.

On what safe and intelligible ground can this exception stand? There is no expression in the constitution, no sentiment delivered by its contemporaneous expounders, which would justify us in making it. In the absence of all authority of this kind, is there, in the nature and reason of the case itself, that which would sustain a construction of the constitution not warranted by its words? Are contracts of this description of a character to excite so little interest that we must exclude them from the provisions of the constitution as being unworthy of the attention of those who framed the instrument? Or does public policy so imperiously demand their remaining exposed to legislative alteration as to compel us, or rather permit us,

to say that these words, which were introduced to give stability to contracts, and which in their plain import comprehend this contract, must yet be so construed as to exclude it?

Almost all eleemosynary corporations, those which are created for the promotion of religion, of charity, or of education, are of the same character. The law of this case is the law of all. In every literary or charitable institution, unless the objects of the bounty be themselves incorporated, the whole legal interest is in trustees, and can be asserted only by them. The donors or claimants of the bounty, if they can appear in court at all, can appear only to complain of the trustees. In all other situations they are identified with, and personated by, the trustees, and their rights are to be defended and maintained by them. Religion, charity and education are, in the law of England, legatees or donees, capable of receiving bequests or donations in this form. They appear in court, and claim or defend by the corporation. Are they of so little estimation in the United States that contracts for their benefit must be excluded from the protection of words which, in their natural import, include them? Or do such contracts so necessarily require new modeling by the authority of the legislature that the ordinary rules of construction must be disregarded in order to leave them exposed to legislative alteration?

All feel that these objects are not deemed unimportant in the United States. The interest which this case has excited proves that they are not. The framers of the constitution did not deem them unworthy of its care and protection. They have, though in a different mode, manifested their respect for science by reserving to the government of the Union the power "to promote the progress of science and useful arts by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." They have so far withdrawn science and the useful arts from the action of the state governments. Why, then, should they be supposed so regardless of contracts made for the advancement of literature as to intend to exclude them from provisions made for the security of ordinary contracts between man and man? No reason for making this supposition is perceived.

If the insignificance of the object does not require that we

should exclude contracts respecting it from the protection of the constitution, neither, as we conceive, is the policy of leaving them subject to legislative alteration so apparent as to require a forced construction of that instrument in order to effect it. These eleemosynary institutions do not fill the place which would otherwise be occupied by government, but that which would otherwise remain vacant. They are complete acquisitions to literature. They are donations to education, donations which any government must be disposed rather to encourage than to discountenance. It requires no very critical examination of the human mind to enable us to determine that one great inducement to these gifts is the conviction felt by the giver that the disposition he makes of them is immutable. It is probable that no man ever was, and that no man ever will be, the founder of a college, believing at the time that an act of incorporation constitutes no security for the institution; believing that it is immediately to be deemed a public institution, whose funds are to be governed and applied, not by the will of the donor, but by the will of the legislature. All such gifts are made in the pleasing, perhaps delusive, hope that the charity will flow forever in the channel which the givers have marked out for it. If every man finds in his own bosom strong evidence of the universality of this sentiment, there can be but little reason to imagine that the framers of our constitution were strangers to it, and that, feeling the necessity and policy of giving permanence and security to contracts, of withdrawing them from the influence of legislative bodies, whose fluctuating policy and repeated interferences produced the most perplexing and injurious embarrassments, they still deemed it necessary to leave these contracts subject to those interferences. The motives for such an exception must be very powerful to justify the construction which makes it.

The motives suggested at the bar grow out of the original appointment of the trustees, which is supposed to have been in a spirit hostile to the genius of our government, and the presumption that, if allowed to continue themselves, they now are, and must remain forever, what they originally were. Hence is inferred the necessity of applying to this corporation, and to other similar corporations, the correcting and improving hand of the legislature.

It has been urged repeatedly, and certainly with a degree of earnestness which attracted attention, that the trustees, deriving their power from a regal source, must necessarily partake of the spirit of their origin, and that their first principles, unimproved by that resplendent light which has been shed around them, must continue to govern the college and to guide the students. Before we inquire into the influence which this argument ought to have on the constitutional question, it may not be amiss to examine the fact on which it rests. The first trustees were undoubtedly named in the charter by the crown, but at whose suggestion were they named? By whom were they selected? The charter informs us. Dr. Wheelock had represented "that, for many weighty reasons, it would be expedient that the gentlemen whom he had already nominated in his last will to be trustees in America should be of the corporation now proposed." When, afterwards, the trustees are named in the charter, can it be doubted that the persons mentioned by Dr. Wheelock in his will were appointed? Some were probably added by the crown, with the approbation of Dr. Wheelock. Among these is the doctor himself. If any others were appointed at the instance of the crown, they are the governor, three members of the council, and the speaker of the house of representatives of the colony of New Hampshire. The stations filled by these persons ought to rescue them from any other imputation than too great a dependence on the crown. If, in the revolution that followed, they acted under the influence of this sentiment, they must have ceased to be trustees; if they took part with their countrymen, the imputation which suspicion might excite would no longer attach to them. The original trustees, then, or most of them, were named by Dr. Wheelock, and those who were added to his nomination, most probably with his approbation, were among the most eminent and respectable individuals in New Hampshire.

The only evidence which we possess of the character of Dr. Wheelock is furnished by this charter. The judicious means employed for the accomplishment of his object, and the success which attended his endeavors, would lead to the opinion that he united a sound understanding to that humanity and benevolence which suggested his undertaking. It surely can

not be assumed that his trustees were selected without judgment. With as little probability can it be assumed that, while the light of science and of liberal principles pervades the whole community, these originally benighted trustees remain in utter darkness, incapable of participating in the general improvement; that, while the human race is rapidly advancing, they are stationary. Reasoning *a priori*, we should believe that learned and intelligent men, selected by its patrons for the government of a literary institution, would select learned and intelligent men for their successors; men as well fitted for the government of a college as those who might be chosen by other means. Should this reasoning ever prove erroneous in a particular case, public opinion, as has been stated, at the bar, would correct the institution. The mere possibility of the contrary would not justify a construction of the constitution which should exclude these contracts from the protection of a provision whose terms comprehend them.

The opinion of the court, after mature deliberation, is that this is a contract, the obligation of which cannot be impaired without violating the constitution of the United States. This opinion appears to us to be equally supported by reason and by the former decisions of this court.

2. We next proceed to the inquiry whether its obligation has been impaired by those acts of the legislature of New Hampshire to which the special verdict refers.

From the review of this charter which has been taken it appears that the whole power of governing the college, of appointing and removing tutors, of fixing their salaries, of directing the course of study to be pursued by the students, and of filling up vacancies created in their own body, was vested in the trustees. On the part of the crown it was expressly stipulated that this corporation, thus constituted, should continue forever, and that the number of trustees should forever consist of twelve, and no more. By this contract the crown was bound, and could have made no violent alteration in its essential terms without impairing its obligation.

By the revolution the duties, as well as the powers, of government devolved on the people of New Hampshire. It is admitted that among the latter was comprehended the transcendant power of parliament, as well as that of the executive

department. It is too clear to require the support of argument that all contracts and rights respecting property remained unchanged by the revolution. The obligations, then, which were created by the charter to Dartmouth College were the same in the new that they had been in the old government. The power of the government was also the same. A repeal of this charter at any time prior to the adoption of the present constitution of the United States would have been an extraordinary and unprecedented act of power, but one which could have been contested only by the restrictions upon the legislature to be found in the constitution of the state. But the constitution of the United States has imposed this additional limitation, that the legislature of a state shall pass no act "impairing the obligation of contracts."

It has been already stated that the act "to amend the charter, and enlarge and improve the corporation of Dartmouth College," increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, to consist of twenty-five persons, of whom twenty-one are also appointed by the executive of New Hampshire, who have power to inspect and control the most important acts of the trustees.

On the effect of this law two opinions cannot be entertained. Between acting directly and acting through the agency of trustees and overseers no essential difference is perceived. The whole power of governing the college is transferred from trustees appointed according to the will of the founder, expressed in the charter, to the executive of New Hampshire. The management and application of the funds of this eleemosynary institution, which are placed by the donors in the hands of trustees named in the charter, and empowered to perpetuate themselves, are placed by this act under the control of the government of the state. The will of the state is substituted for the will of the donors in every essential operation of the college. This is not an immaterial change. The founders of the college contracted not merely for the perpetual application of the funds which they gave to the objects for which those funds were given; they contracted also to secure that application by the constitution of the corporation. They contracted for a system which should, as far as human foresight can provide,

retain forever the government of the literary institution they had formed in the hands of persons approved by themselves. This system is totally changed. The charter of 1769 exists no longer. It is reorganized, and reorganized in such a maner as to convert a literary institution, moulded according to the will of its founders, and placed under the control of private literary men, into a machine entirely subservient to the will of government. This may be for the advantage of this college in particular, and may be for the advantage of literature in general, but it is not according to the will of the donors, and is subversive of that contract on the faith of which their property was given.

In the view which has been taken of this interesting case, the court has confined itself to the rights possessed by the trustees, as the assignees and representatives of the donors and founders, for the benefit of religion and literature. Yet it is not clear that the trustees ought to be considered as destitute of such beneficial interest in themselves as the law may respect. In addition to their being the legal owners of the property, and to their having a freehold right in the powers confided to them, the charter itself countenances the idea that trustees may also be tutors with salaries. The first president was one of the original trustees, and the charter provides that in case of vacancy in that office "the senior professor or tutor, being one of the trustees, shall exercise the office of president until the trustees shall make choice of and appoint a president." According to the tenor of the charter, then, the trustees might, without impropriety, appoint a president and other professors from their own body. This is a power not entirely unconnected with an interest. Even if the proposition of the counsel for the defendant were sustained; if it were admitted that those contracts only are protected by the constitution, a beneficial interest in which is vested in the party who appears in court to assert that interest; yet it is by no means clear that the trustees of Dartmouth College have no beneficial interest in themselves.

But the court has deemed it unnecessary to investigate this particular point, being of opinion, on general principles, that in these private eleemosynary institutions the body corporate, as possessing the whole legal and equitable interest, and com-

pletely representing the donors, for the purpose of executing the trust, has rights which are protected by the constitution.

It results from this opinion that the acts of the legislature of New Hampshire, which are stated in the special verdict found in this cause, are repugnant to the constitution of the United States, and that the judgment on this special verdict ought to have been for the plaintiffs. The judgment of the state court must therefore be reversed.

Power to Amend and Alter.

YEATON v. BANK OF THE OLD DOMINION.

21 Grattan 593 (Va.). 1872.

Action of assumpsit by the bank against Yeaton to recover the sum of $561.07, and interest; the defense was a tender of the amount in notes issued by the branch bank at Pearisburg. The mother bank was located at Alexandria, and the legislature reserved the "right to repeal, alter or modify the charter at its pleasure;" the branch bank was subject to the charter of the mother bank, and its notes were to "be received in payments of debts due the bank, whether contracted at the parent bank or at the branch bank." During the war, while Alexandria was in possession of the United States authorities, and Pearisburg not, the Virginia legislature authorized the branch bank to issue notes of smaller denomination than the original charter allowed; these notes became greatly depreciated, and were the ones tendered in payment of the debt. Neither the directors nor stockholders ever accepted any amendment of the charter. Judgment below was for the bank, and this is the error assigned.

CHRISTIAN, J. * * * The power of the legislature "to repeal, alter or modify the charter of any bank at its pleasure," must be held to be limited to this extent. It may certainly repeal the charter of any bank, but it can not compel a bank to accept an amendment or modification of its charter. Nor is any such amendment or modification of its charter binding upon the bank without its acceptance. Banks are private corporations, created by a charter or act of incorporation from

the government, which is in the nature of a contract, and, therefore, in order to complete the creation of such corporations, something more than the mere grant of a charter is required; that is, in order to give to the charter the full force and effect of an executed contract, it must be accepted. It is clear that the government can not enforce the acceptance of a charter upon a private corporation without its consent. * * * These well-settled principles are everywhere recognized as applicable to the original charters of incorporation, and upon principle and authority they apply with equal force to any amendment or modification of the charter as well as to the original charter. Though the legislature may have the reserved power to amend or modify a charter of incorporation, it can no more force the corporation to accept such amendment or modification than it could have forced upon them the acceptance of the original charter without their consent. Under the reservation they can repeal or destroy the charter, without any consent on the part of the corporators, but as long as they remain in existence as a corporate body, they necessarily have the power to reject an amendment or modification of their charter. The power reserved by the legislature gives the right certainly to repeal or destroy, but so far as the right to modify or alter is concerned, it is nothing more than the ordinary case of a stipulation that one of the parties to a contract may vary its terms with the consent of the other contracting party. These principles grow out of the nature of charters or acts of incorporation, which are regarded in the nature of contracts. The amendment or modification must be made by the parties to the contract, the legislature on the one hand and the corporation on the other, the former expressing its intention by means of a legislative act and the latter assenting thereto by a vote of the majority of the stockholders, according to the provisions of its charter, or by other acts showing its acceptance.

The reservation of the right to alter, amend or repeal the act by which the corporation is created may be prudent and salutary, but it seems to be a necessary implication that if the legislature should undertake to make what in their opinion is a legitimate alteration or amendment, the corporation has the power to reject or accept it whatever may be the consequences.

One consequence undoubtedly is, that the corporation can not conduct its operations in defiance of the power that created it; and if it does not accept the modification or amendment proposed, must discontinue its operations as a corporate body. But such amendment or modification can not be forced upon the corporation without its consent. Sage, etc., v. Dillard, etc., 15 B. Mon. R. 340; Allen v. McKean, 1 Sumner's R. 277; Durfee v. Old Colony and Fall River R. Co., 5 Allen's R. 230. Every amendment or modification of a charter of incorporation is nothing more than a new contract, which is not binding upon the corporate body until accepted by them. Applying these doctrines, which seem to be well settled, to the case before us, it is manifest that the Bank of Old Dominion can not be held bound by the acts of 1862 as amendments of its charter. * * *

It is no answer to this view that the branch bank at Pearisburg was within the territorial jurisdiction of the Richmond government, and subject to its authority. This bank was not an independent corporation. It had no charter; it was but a branch of its mother bank at Alexandria, subject to its charter. It was but the agent, the mother bank being its principal. It could do no act to bind its principal without the consent and authority of that principal. Nor could the legislature authorize the branch bank which owed its existence to the charter of the mother bank to issue small notes, or to do any other act as a bank without the consent of the mother bank. The only authority which the legislature could exercise was that which it reserved under the power "to repeal, modify or alter" the charter of the mother bank. I have already shown that this was not done by the acts of 1862, which could not operate upon the Bank of the Old Dominion as a change or modification of its charter. * * *

Affirmed.

CHAPTER VII.

CORPORATE POWERS.

Power to Borrow Money and Issue Negotiable Paper.

BRADBURY v. BOSTON CANOE CLUB.

153 Mass. 77, 26 N. E. 132. 1891.

HOLMES, J.—This is an action upon a promissory note for $150 and interest, given by the defendant to the plaintiff for money lent to it by the plaintiff to be used in building a club-house. There is a second count for money lent. At a meeting duly called the corporation passed a vote authorizing its treasurer to borrow money in terms sufficiently broad to cover the loan in question. The suggestion that no sufficient notice of the business to be transacted was given, does not seem to us fairly open on the agreed facts. Moreover, it would be impossible to argue that the defendant had not recognized and ratified the act of its treasurer in borrowing from the plaintiff. The money was received by the corporation, and was used by it for the purpose mentioned. The only question for us is, whether the corporation acted illegally in borrowing money for the purpose of erecting a club-house upon land of which it held a lease.

The defendant is a corporation formed under the Public Statutes, ch. 115, § 2, for encouraging athletic exercises. By section 7 it "may hold real and personal estate, and may hire, purchase, or erect suitable buildings for its accommodations, to an amount not exceeding $500,000," etc. We are of opinion that under these words the defendant had power to take a lease of land and to erect a suitable club-house upon it. Having this power it was entitled to raise money for the purpose. No argument is needed to show that the power at the end of section 7 to receive and hold in trust funds received by gift or bequest does not confine the corporation to that mode of raising it. Borrowing money is a usual and proper means of

accomplishing what the statute expressly permits. See Fay v. Noble, 12 Cush. 1, 18; Morville v. American Tract Society, 123 Mass. 129, 136; Davis v. Old Colony Railroad, 131 Mass. 258, 271, 275. As this is a sufficient reason for giving the plaintiff judgment, it is unnecessary to consider whether there are not others.

Judgment for the plaintiff.

Power to Make or Endorse Accommodation Paper.

MONUMENT NATIONAL BANK v. GLOBE WORKS.

101 Mass. 57. 1869.

HOAR, J. * * * The single question presented for our decision in this cause, all others which arise upon the report having been waived, is, whether the note of a manufacturing corporation, in the hands of a holder in good faith for value, who took it before maturity, and without any knowledge that the makers had not received the full consideration, can not be enforced against them, because it was in fact made as an accommodation note.

The argument for the defendants takes the ground that to issue an accommodation note is not within the powers conferred upon the corporation; and that, as any persons taking it had notice that it was the note of the corporation, they had notice that it was of no validity unless issued for the purpose within the scope of the corporate powers, and were, therefore, bound to ascertain not only that it was executed by the officer of the corporation who had the general authority to sign the notes which they might lawfully make, but that the purpose for which it was issued was such as the charter authorized them to entertain and execute.

The court are all of opinion that this position is not tenable, and that the defense can not be maintained.

It has long been settled in this commonwealth that a manufacturing corporation has the power to make a negotiable promissory note. Narragansett Bank v. Atlantic Silk Co., 3 Met. 282. And it was held in Bird v. Daggett, 97 Mass. 494, as a just corollary to that proposition, that such note in the

hands of a holder in good faith for value is binding upon the maker, although made as an accommodation note. The question was not discussed, nor the reasons for the decision fully stated in Bird v. Daggett; but it was assumed that the doctrine announced was clear and undoubted law.

The doctrine of ultra vires has been carried much farther in England than the courts in this country have been disposed to extend it; but, with just limitations, the principle can not be questioned, that the limitations to the authority, powers, and liability of a corporation are to be found in the act creating it. And it no doubt follows, as claimed by the learned counsel for the defendants, that when powers are conferred and defined by statute, everyone dealing with the corporation is presumed to know the extent of those powers.

But when the transaction is not the exercise of a power not conferred on a corporation, but the abuse of a general power in a particular instance, the abuse not being known to the other contracting party, the doctrine of ultra vires does not apply. As was said by Selden J., in Bissell v. Michigan Southern and Northern Indiana Railroad Company, 22 N. Y. 289, 290: "There are no doubt cases in which a corporation would be estopped from setting up this defense, although its contract might have been really unauthorized. It would not be available in a suit brought by a bona fide indorsee of a negotiable promissory note, provided the corporation was authorized to give notes for any purpose; and the reason is, that the corporation, by giving the note, has virtually represented that it was given for some legitimate purpose; and the indorsee could not be presumed to know the contrary. The note, however, if given by a corporation, absolutely prohibited by its charter from giving notes at all, would be voidable not only in the hands of the original payee, but in those of any subsequent holder; because all persons dealing with a corporation are bound to take notice of the extent of its chartered powers. The same principle is applicable to contracts not negotiable. When the want of power is apparent upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defense of ultra vires is available against him. But such a defense would not be permitted to prevail against a party

who can not be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts, resting peculiarly within the knowledge of the corporate officers, then the corporation would be estopped from denying that which, by assuming to make the contract, it had virtually affirmed.

This doctrine seems to us sound and reasonable; and in conformity with it, it was held, in Farmers' and Mechanics' Bank v. Empire Stone Dressing Company, 5 Bosw. 275, that an accommodation acceptance by an officer of a manufacturing corporation, on behalf of the company, was not binding, unless the consideration had been advanced upon the face of the acceptance; but that if the consideration was paid in good faith after the acceptance, and upon the credit of it, it could be enforced. * * *

Judgment for plaintiffs.

Power to Make or Endorse Accommodation Paper.

MURPHY ET AL. v. ARKANSAS & L. LAND IMPROVEMENT COMPANY.

97 Fed. 723. 1899.

Bill to foreclose a trust deed. P. F. B. owned one-third of a $30,000 judgment in favor of the A. & L. R. Co. against J. D. B. In order to discharge this third, J. D. B. paid P. F. B. $6,000, and delivered to him a note for $4,000, secured by a deed of trust, executed by the Land Company, and made payable to J. D. B. or his assignee, for the purpose of enabling him to pay his claim. The note and deed were executed with the full consent of all the directors and shareholders of the Land Company, composed of J. D. B., who owned all the stock except shares necessary to qualify a son of J. D. B. and his attorney to be directors; also at a time when the corporation had ample property to pay all its debts, including this claim. P. F. B. assigned the note and deed of trust in the ordinary course of business to Murphy, who brings the suit.

ROGERS, DISTRICT JUDGE. * * * It is urged that the land company had no authority to execute accommodation paper, and hence the execution of the note was ultra vires. I incline to think that the charter of the land company is broad enough to authorize it to execute accommodation paper, but it makes no difference as to that. The land company is a private corporation. It owed no debts. The paper was issued by the consent of all the stockholders, and it has been accepted, and the consideration parted with by P. F. B. for it. Can it now be permitted to take shelter under the plea of ultra vires? I think not. In 1 Cook Corp., § 3, the author says:

"A private corporation may become an accommodation indorser, distribute its assets, issue its notes, stock, or bonds below par, or, for no consideration whatever, give away its assets, or may mortgage its property for the personal benefit of a part or all of its stockholders or officers; provided, always, that all the stockholders assent, and provided that corporate creditors are not injured, and provided that no statute forbids such acts. The doctrine of ultra vires is no longer held to forbid such acts by a private corporation under such circumstances. * * * The theory of a corporation is that it has no powers except those expressly given or necessarily implied. But this theory is no longer strictly applied to private corporations. A private corporation may exercise many extraordinary powers, provided all of its stockholders assent, and none of its creditors are injured. There is no one to complain except the state, and, the business being entirely private, the state does not interfere. Thus, fifty years ago the courts would have summarily declared it illegal for a business corporation to become an accommodation indorser of commercial paper, but today there is no rule of public policy which prohibits a private corporation having a capital stock from becoming the accommodation indorser of commercial paper, providing such indorsement is made with the knowledge and assent of all the directors and stockholders, and provided corporate creditors are paid."

In the subsequent discussion of the author it is shown that whatever is done by a private corporation with the assent of all of its stockholders, and where no creditor is injured, although it may be ultra vires, is lawful, and will be enforced

by the courts. The principle does not apply to railroad corporations or quasi-public corporations. * * *

Decree for plaintiff.

Power to Acquire Its Own Shares of Stock.

CHICAGO R. CO. v. PRESIDENT OF MARSEILLES.

84 Ill. 643. 1877.

Per Curiam: On considering the petition heretofore filed, we granted a rehearing to further consider the question, whether the railroad company had the power to contract for and purchase shares of stock of its own company. We have again fully examined the question, and, after considering the arguments and authorities bearing on the question, we will proceed to announce our conclusions thus reached.

The rule is familiar, and is not contested, that such bodies can only exercise such powers as may be conferred by the legislative body creating them, either in express terms or by necessary implication; and the implied powers are presumed to exist to enable such bodies to carry out the express powers granted, and to accomplish the purposes of their creation. Such being the rule, the question arises, whether this corporate body might make such a purchase, or is it outside of, and beyond the limit of its power?

Appellant has referred us to a number of cases in our own court, in which it has been held that such organizations have no power to release subscribers for their stock from paying therefor and from their subscriptions; that, when such subscriptions are intended to be fictitious or the subscribers are released from payment, it operates as a wrong, if not a fraud, on the other subscribers for stock in the same company. But here, the stock had been subscribed, paid for, and certificates thereof issued to, and they were owned and held by, the village at the time this contract was entered into and executed. So, the question is not, whether appellant may release the village from paying for and receiving shares subscribed for, but whether appellant has power to purchase shares of its own stock, paid for, issued to and held by the village.

In the case of Taylor v. Miami Exportation Co., 6 Ohio

(Hammond's R.) 83, it was held that a banking corporation might lawfully receive shares of its own stock from a solvent debtor in discharge of his indebtedness. The court went further, and held that, where a large number of shares had been issued to enable the holder to vote for certain persons for directors at an approaching election, and, after the holder had thus voted, the money paid for the shares was returned to him, and he restored the shares to the bank, as there was no loss sustained by the transaction, and the result of the election was not changed, and whilst the court condemned the transaction, it held that equity could afford no relief, as no one had been injured. It was also held in that case that, where the shares of that company were transferred to it in payment of such indebtedness, the corporation might hold and sell it as it did its other property.

In the case of the City Bank of Columbus v. Bruce, 17 N. Y. 507, it appeared that the board of directors passed a resolution that all stockholders indebted to the bank on stock note, by a specified day, might pay such debts to the bank in its shares of stock, at a named per cent., and that not far from half of the stock of the bank was thus surrendered; and the court held, there was no ground for questioning the validity of the transaction; that no rule of common law or any provision of the charter forbade it; and the Ohio case is referred to and approved by the court.

In the case of William v. The Savage Manufacturing Company, 3 Md. Ch. R. 452, it was held that banking corporations had the right to take shares of their own stock in pledge or payment of indebtedness to the corporation, and to reissue the same. On the latter proposition Ex parte Holmes, 5 Cow. 426, is referred to by the court in its support.

In the case of The State v. Smith, 48 Vt. R. 266, it was held that where a railroad company had purchased 2,350 shares of the stock of the company, the stock did not merge, and the legality of the purchase seems to be recognized by the court. And in further supports of the rule, see Angell and Ames on Corp., sec. 280, where it is said it is one of the corporate powers that may be legally exercised.

If, then, as in cases above referred to, a bank may purchase and hold its own shares, no reason is perceived why a rail-

road corporation may not do the same thing, and the case of The State v. Smith, supra, was, the purchase of stock by a railroad company, and of shares of its own stock. These authorities, we think, fully recognize the power of the directors of a company, when not prohibited by their charter, to purchase shares of stock of their company. It falls within the scope of the powers of the directors to manage and control the affairs and property of the company for the best interests of the stockholders and when they have thus acted, we will presume, until the contrary is shown that the purchase was for legitimate and authorized purposes.

If it were shown that the purchase was made to promote the interests of the officers of the company alone, and not the stockholders generally, or if for the benefit of a portion of the stockholders and not all, or for the injury of all or only a portion of them, or if operated to the injury of creditors, or would defeat the end for which the body was created, or if it was done for any other fraudulent purpose, then chancery could interfere. In such case, Melvin v. The Lamar Ins. Co., 80 Ill. 446, and other cases in chancery referred to in appellant's brief, would apply, but the defense cannot be made at law. The case of Belford Railroad Co. v. Bowser, 48 Pa. St. R. 29, was in a court where there is no distinction between actions at law and suits in equity, and we presume the defense was allowed by the application of equitable principles, and the cases in the British courts which seem to bear on the question were in equity. Whatever may be the rights of stockholders, or creditors, if there are any, relief can only be had in equity and by a stockholder or other cestui que trust.

The judgment of the court below will, therefore, be affirmed.

Power to Enter Into a Partnership.

MALLORY v. HANANER OIL WORKS.

86 Tenn. 598, 8 S. W. 396. 1888.

Appeal in error from circuit court of Shelby county.

LURTON, J.—This is an action of unlawful detainer, brought by the Hananer Oil Works, a corporation created under the

General Incorporation Act of 1875, and engaged in the manufacture of cotton-seed oil at Memphis, Tenn.

The facts which raise the question to be determined are these: In July, 1884, a contract was entered into by and between four corporations engaged in manufacturing cotton-seed oil at Memphis for the formation of what is designated in the agreement as a "combination," "syndicate," and "partnership." The contracting mills agreed to select a committee, composed of representatives from each corporation, and to turn over to this committee the properties and machinery of each mill, to be managed and operated by this committee, through officers, agents and employes selected by them, for the common benefit, the profits and losses of such operations to be shared in proportions agreed upon. This arrangement was to last one year, but, with consent of all, might be renewed for two additional years, and, as appears, was at the end of first year renewed for two other years, terminating August 1, 1887. * * *

The charter is the measure of its powers, and the enumeration thereof implies the exclusion of all others. We are not to look to the charter to see whether the thing done be prohibited, but whether there is authority to do it. These principles we understand to have the support of the great weight of authority in this country, and to have the sanction of the supreme court of the United States. Thomas v. Railroad Co., 101 U. S. 71.

This view of the law has been the one entertained by this court, and clearly and distinctly enforced in an opinion by the present chief justice in the case of Elevator Company v. Memphis and Charleston R. Co., 1 Pick. 703. The power to enter into a partnership is not expressly or impliedly conferred by our act of 1875, under which the Hananer Oil Works is incorporated. Neither is such authority within the implied powers of corporations. A partnership and a corporation are incongruous. Such a contract is wholly consistent with the scope and tenor of the powers expressly conferred and the duties expressly enjoined upon a corporation, whether it be a strictly business and private corporation or one owing duties to the public, such as a common carrier. In a partnership each member binds the firm when acting within the scope of the busi-

ness. A corporation must act through its directors or authorized agents, and no individual member can, as such member, bind the corporation.

Now, if a corporation be a member of a partnership it may be bound by any other member of the association, and in so doing he would act, not as an officer or agent of the corporation, and by virtue of authority received from it, but as a principal in an association in which all are equal, and each capable of binding the society by his acts. The whole policy of the law creating and regulating corporations looks to the exclusive management of the affairs of each corporation by the officers provided for or authorized by its charter. This management must be separate and exclusive, and any arrangement by which the control of the affairs of the corporation should be taken from its stockholders and the authorized officers and agents of the corporation would be hostile to the policy of our general incorporation acts. The decided weight of authority is that a corporation has not the power to enter a partnership, either with other corporations or with individuals. Says Mr. Morawetz: "It seems clear that corporations are not impliedly authorized to enter into partnership with other corporations or individuals. The existence of a partnership not only would interfere with the management of the corporation by its regularly appointed officers, but would impair the authority of the shareholders themselves, and involve the company in new responsibilities through agents over whom it had no control." 1 Morawetz Corp., § 421; Whittenton Mills v. Upton, 10 Gray 528 (s. c. 71 Am. Dec. 681); Angell & Ames Corp., § 272.

It is unnecessary to consider this contract as constituting a mere traffic arrangement; for the conclusion already announced that it was an effort to form a partnership, determines that in its scope and effect it sought to accomplish much more than would be understod by the phrase "traffic arrangement."

Affirmed.

CHAPTER VIII.

ULTRA VIRES TRANSACTIONS.

Acquisition of Property.

HUBBARD v. WORCESTER ART MUSEUM.

194 Mass. 280, 80 N. E. 490. 1907.

KNOWLTON, C. J.—This is a petition brought by the heirs of Stephen Salisbury, late of Worcester, deceased, for leave to file an information in the nature of a quo warranto against the respondent, under the R. L. c. 192, §§ 6-13. The Worcester Art Museum is a corporation established under the provisions of the Pub. Sts. c. 115 (R. L. c. 125), "for the purpose," as set forth in its certificate of incorporation, "of founding an institution for the promotion of art and art education in said Worcester; erecting and maintaining buildings for the preservation and exhibition of works and objects of art; making and exhibiting collections of such works, and providing instruction in the industrial, liberal, and fine arts; for holding real and personal estate in the furtherance of this purpose; and for the holding and administering funds acquired by the corporation for these and kindred objects in accordance with the will of the donors. All of said property and funds of the corporation, however, are to be held solely in trust for the benefit of all the people of the city of Worcester." By the will of Mr. Salisbury this corporation is made his residuary legatee, and if the intention of the testator is carried out, it will receive, under the will, real and personal estate amounting in value to between $2,000,000 and $3,500,000. By the R. L. c. 125, § 8, such corporations are authorized to "hold real and personal estate to an amount not exceeding one million five hundred thousand dollars." By the St. 1906, c. 312, enacted after the probate of the will, the right of this respondent to hold real and personal estate was enlarged to an amount not exceeding $5,000,000. The petitioners contend that,

by reason of the limitation in the statute, the gift was void; that, as heirs at law of the testator, their rights in this part of his estate became vested on the probate of the will; that the St. 1906 is prospective in its operation, and does not affect the right of the respondent to hold property under this will, and that, if it were construed as applying to property devised by this will, it would be unconstitutional and void.

The statute under which the petition is brought has been considered in Goddard v. Smithett, 3 Gray 116, in Hartnett v. Plumbers' Supply Association, 169 Mass. 229, and in other cases. We will assume in favor of the petitioners, without deciding, that if they were right in their view of the questions of substantive law involved, it would be available to give them the remedy which they seek. We come directly to the effect of the residuary clause in the will.

The attack upon its validity may be considered from two points of view: first, in reference to the rights of testators, as against their heirs, to dispose of their property for charitable or other purposes; secondly, in reference to the provisions of the law giving this kind of corporations a right to hold property to an amount not exceeding a certain sum.

From the first point of view this gift is perfect and complete. Except for the protection of the statutory rights of a husband or wife, the power of a testator in this commonwealth to dispose of his estate by will is unlimited. There is nothing in our law to restrain one from giving free course to his charitable inclinations, up to the last moment of his possession of a sound, disposing mind. Making charitable gifts in this commonwealth is not against public policy, and we have no legislation, such as has long existed in England and in New York and some of the other American states, putting obstacles in the way of testamentary acts. The only ground of objection to this part of the will is not from the point of view of the testator or of his heirs, but on account of the provisions of the statute regulating the rights of corporations as to the holding of property. We must, therefore, determine the meaning and effect of this statute on which the petitioners rely.

They contend that it is by implication an absolute prohibition against the holding, at any time, in any form, for any purpose, of a greater amount of property than that stated, and that

any attempt of a corporation to hold more, or of any person to put more into the ownership of a corporation, is illegal and absolutely void. The respondent contends that this implied limitation of the right to hold is made on grounds of public policy; that it is a provision only in favor of the state, which the state may enforce or not, as it chooses; that grants or devises in excess of the amounts stated are not void, but only voidable; that third persons can not question the validity of such grants or devises, but that they are legal so long as the state leaves them undisturbed, and that the state may at any time, by a legislative act or in some other proper way, completely waive its right of enforcement.

In interpreting the act the history of earlier kindred provisions may be helpful. At common law, corporations were authorized to acquire and hold both real and personal property without limit. In re McGraw's Estate, 111 N. Y. 66, 84. "The creation of a corporation gives to it, amongst other powers, as incident to its existence, and without any express grant of such powers, that of buying and selling." Bank v. Poitiaux, 3 Rand. 136. "A corporation has, from its nature, a right to purchase lands, though the charter contains no license to that purpose." Leazure v. Hillegas, 7 S. & R. 313. See also Page v. Heineberg, 40 Vt. 81; Mallett v. Simpson, 94 N. C. 37, 41.

Under the feudal system, when land was given to a corporation, the chief lords of whom the land was held, and the king as ultimate chief lord, lost their chances of escheat, and various other rights and incidents of military tenure. During the middle ages, the accumulation of land in the ecclesiastical corporations was so great as to be thought a national grievance. Hence the English mortmain acts, which go back for their origin to Magna Charta, St. 9 Hen. III, c. 36, and which have continued with various modifications to this day. See 7 Edw. I, c. 2; 15 Rich. II, c. 5; Shelford on Mortmain, 2, 6, 8, 16, 25, 34, 39, 809, 812; Tyssen on Charitable Bequests, 2, 383. Under these acts the alienations were not void, so as to let in the grantors and their heirs; but they merely operated as a forfeiture, which gave a right to the mesne lord and the king to enter after due inquest. This right to enter was often waived by a license in mortmain. See citations above, and Tyssen on Charitable Bequests, 383; St. 7 & 8 Will. III, c. 37.

In form these licenses commonly authorized a holding of property "not exceeding" a certain value. In later years this authority sometimes has been inserted in the charter, and this limited power of purchase has, it is said, been exceeded by almost all corporations. Shelford on Mortmain, 55. See also pages, 10, 44, 49, 56, 891; Tyssen on Charitable Bequests, 393, 394, 396.

Another act, St. 9 Geo. II, c. 36, which is usually called "The Mortmain Act," but is called by Tyssen the "Georgian Mortmain Act," is of a very different nature. One of its purposes, as declared in the preamble, is to avoid "improvident alienations or disposition made by languishing or dying persons, or by other persons, to uses called charitable uses, to take place after their deaths, to the disherison of their lawful heirs." Considered in reference to its purposes, it is not properly called a mortmain act. It applies only to gifts for charitable uses; and under it all such gifts, unless made as the statute allows, are absolutely void.

We never have had any real mortmain acts in Massachusetts. The nearest approach to one was the Prov. St. 1754-55, c, 12; 3 Prov. Laws (State ed.) 778. This made deacons a corporation to take gifts for charitable purposes, limited the grants to such as would produce an income not exceeding three hundred pounds a year, and provided that they should be made by deed, three months before death, and that all bequests, devises, or later grants should be void. This statute related only to gifts to deacons, and was repealed by St. 1785, c. 51 (February 20, 1786), which reënacted a part of the law, but omitted the provision that gifts not authorized by the act should be void. Bartlet v. King, 12 Mass. 537, 545. See R. L. c. 37, § 1.

The significance of this reference to English law and to our legislation is, first, that, except for this short period, we have never had in Massachusetts any legislation prohibiting charitable gifts to trustees or corporations, or providing that any kind of conveyances, devises, or bequests to corporations shall be void. On the other hand, the policy of the commonwealth, as expressed both by legislation and the decisions of its courts, has been exceedingly liberal to testators and public charities. Sanderson v. White, 18 Pick. 328, 333, 334; American Academy v. Harvard College, 12 Gray 582, 595, 596; Saltonstall v. San-

ders, 11 Allen 446; Jackson v. Phillips, 14 Allen 539, 550. Secondly, the implied limitations upon the power of corporations to hold property, which appear in numerous enactments, have been made, not in the interest of grantors or devisors or their heirs, but in the interest of the state, on considerations of public policy. The general form of these limitations, which appears in the statute before us, and with slight variations in special charters (a list of which, two hundred and seventy-four in number, granted in this state before 1850, has been furnished us through the industry of counsel) corresponds with the form of licenses granted by the Crown in England under the old mortmain acts, and sometimes embodied in charters granted by parliament. Under these English acts, grants or devises to a corporation to hold property without a license, or in excess of the amount licensed, were not void, but only voidable by the mesne lord or the king, upon entry, after inquest according to law. In view of the close relations between Massachusetts and the mother country in early times, this justifies an argument, of considerable strength, that the implied limitations in our statutes were intended to have no greater force than the old mortmain acts of England, as distinguished from the Georgian mortmain act.

We start with the inherent right, already referred to, of every corporation to take and hold property at common law, by virtue of the act of its creation. This right is recognized in our statutes by implication, without express mention. R. L. c. 109 §§ 4-6. What force is to be given to the words, "may hold real and personal estate to an amount not exceeding one million five hundred thousand dollars"? The respondent contends that their meaning is as if words were added as follows: "and beyond that amount it shall have no right as against the commonwealth; and the commonwealth may take proper measures, through action of the attorney-general or otherwise, to prevent or terminate such larger holding." According to the argument, a taking and holding by a corporation, above the prescribed amount, is under its inherent right. As between it and the state as the guardian of the public interest, a provision as to amount is made, which does not affect its right as to third persons. As to the general legality of the holding, except when the state chooses to

enforce the law for its own benefit, the condition is similar to that resulting from a statutory provision which is merely directory. It is not very unlike the old law as to conveyances to aliens. Such conveyances, whether by grant or devise, were good against every one but the state, and could be set aside only after office found. Fox v. Southack, 12 Mass. 143; Waugh v. Riley, 8 Met. 290; Judd v. Lawrence, 1 Cush. 531; Kershaw v. Kelsey, 100 Mass. 561.

That this is the effect of such limitations in statutes of this kind where the title of the corporation is under a grant, as distinguished from a devise, seems to be the universal rule. * * *

The counsel for one of the petitioners says in his brief, "It is fully conceded at the outset that where a corporation takes and holds property by conveyance, or by executed gift *inter vivos*, contrary to its charter rights, no one but the state can complain. This is settled by a practically unbroken line of decisions in all the states," etc.

But if the statute were a prohibition that renders the holding utterly void, and the taking also void, as is argued in the opinion in In re McGraw's estate, 111 N. Y. 66, anybody interested could take advantage of the violation of law, unless he was precluded by estoppel. Most of the cases which we have cited do not put their decision on the ground of estoppel. Often the question might arise when there was no estoppel. The ground on which most of the cases go is that the implication is not an absolute prohibition, but only a condition affecting the rights of the corporation as between it and the state. If the holding were an illegality which was utterly void, the condition would be the same whether the taking was by grant or devise, and a variety of unfortunate consequences might follow. The property might greatly increase in value after its acquisition, as was the case in Evangelical Baptist Society v. Boston, 192 Mass. 412. In that case, although the property of the corporation largely exceeded in value the amount authorized by the statute, there was no intimation that the holding was illegal, so long as the state did not interfere. See also Humbert v. Trinity Church, 24 Wend. 587, 605. As to all interests of private persons, in the absence of interference by the state, the cases generally treat titles to property held by

corporations in excess of the specially authorized amounts as good. They allow the corporations to give good titles to purchasers of such property.

Some judges, in holding that such titles cannot be taken under wills, endeavor to found a distinction upon the executed character of a title by grant, and suggests that a devise or bequest is executory. It seems to us that there is no good reason for the distinction. When a will is proved and allowed, it takes effect immediately to pass all property affected by it. The provision in the law against large holdings by corporations has no relation to the probate of the will. The act of the testator in executing the will is confirmed and given effect as a complete and executed disposition of the property, by the allowance of the will. In this respect a recorded will does not materially differ from a delivered deed. The heirs at law are bound by one as well as by the other.

The decisions upon the precise point at issue are conflicting. In Jones v. Habersham, 107 U. S. 174, a case similar to that now before us, it was held by the court, in an opinion by Mr. Justice Gray, that "restrictions imposed by the charter of a corporation upon the amount of property that it may hold, can not be taken advantage of collaterally by private persons." In the same case in the circuit court the question had been considered previously, and the same result was reached, in an opinion by Mr. Justice Bradley of the Supreme Court of the United States, which is found in 3 Woods 443, 475. The same rule is established in Maryland. Hanson v. Little Sisters of the Poor, 79 Md. 434; In re Stickney's will, 85 Md. 79, 104. DeCamp v. Dobbins, 2 Stew. (N. J.) 36, 40, was decided by the chancellor on this ground. The decree was affirmed on another ground in the Court of Errors and Appeals, 4 Stew. (N. J.) 671, 690, in an opinion by Beasley, C. J., which contains a dictum disapproving of the view of the chancellor. In Farrington v. Putnam, 90 Maine 405, the court, in a very elaborate opinion, in a case identical in its leading features with that now before us, held that the gift was good. The same doctrine is stated in Brigham v. Peter Bent Brigham Hospital, 126 Fed. Rep. 796, 801; s. c., 134 Fed. Rep. 513, 527. It is also stated in text books. Beach, Corp. (Purdy's ed.), § 825; Thompson, Corp., §§ 5795, 5797.

The leading case which presents the opposite view is In re McGraw's estate, 111 N. Y. 66. Although the decision necessarily puts a construction upon a statute of that state, this construction seems to be materially affected by the policy of New York in reference to charities. Said Judge Peckham, who delivered the opinion: "We have a decided mortmain policy. It is found in our statute in relation to wills, prohibiting a devise to a corporation unless specially permitted by its charter or by some statute to take property by devise." In Chamberlain v. Chamberlain, 43 N. Y. 424, the court refers to the prohibition of devices, and to the N. Y. St. 1860, c. 360, still in force, which makes void all bequests or devises to charity in excess of one-half the testator's property, where he leaves relatives. Other statutes have been passed, limiting the amount that can be devised to certain corporations by one testator, forbidding a devise or bequest to charities, by a person leaving relatives, of more than one-fourth of his estate, and making void such gifts where the will was executed within two months before the death of the testator. Gen. Laws of N. Y. 1901 (Heyd. ed.), 4885, 4891, 4892. The policy of that state in regard to charities has been very unfavorable. See Allen v. Stevens, 161 N. Y. 122, 139, 140; People v. Powers, 147 N. Y. 104; Fosdick v. Hempstead, 125 N. Y. 581.

The doctrine of the New York court is stated as the law in Davidson College v. Chambers, 3 Jones Eq. 253, and adopted in Wood v. Hammond, 16 R. I. 98, 115, and House of Mercy v. Davidson, 90 Tex. 529. In the case in North Carolina the decision was by two of the three judges of the court, the chief justice giving an able dissenting opinion. The courts in Kentucky and Tennessee have expressed approval of the McGraw case in New York, but in terms that do not leave the grounds of their decisions entirely clear. Cromie v. Louisville Orphans' Home Society, 3 Bush 365, 383; Heiskell v. Chickasaw Lodge, 87 Tenn. 668, 686. In reference to supposed errors in the opinion in the last case, see Pritchard on Wills, § 153, note, and Farrington v. Putnam, 90 Maine 405, 433.

In the construction of our statute, when the question arises whether a different rule shall be established in regard to the taking and holding by a corporation under a will from that which is universally laid down in regard to a holding under

a deed, we are much influenced by the policy of our law as to devises and bequests for charitable purposes. We are of opinion that, under the R. L. c. 125, § 8, a gift to a corporation under a will, to an amount in excess of the sum specially authorized, should be held no less valid than a similar acquisition of title under a deed. It is good as against every one but the commonwealth. It follows that the St. 1906, c. 312, operated as a waiver of the commonwealth's right to terminate the holding, and a legislative declaration of the entire validity of the provision in the will.

If we are wrong in this conclusion, the petition must be dismissed on an independent ground. (The judge held also that the gift could be sustained as a gift to a public charity.)

Petition dismissed.

Ultra Vires Contracts.

RAILWAY COMPANIES v. KEOKUK BRIDGE CO.

131 U. S. 371. 1889.

MR. JUSTICE GRAY. * * * The outlines of the doctrine of ultra vires, and the reasons on which it rests, have been clearly stated in previous judgments of this court.

The reasons why a corporation is not liable upon a contract ultra vires, that is to say, beyond the powers conferred upon it by the legislature, and varying from the objects of its creation as declared in the law of its organization, are: 1st. The interest of the public, that the corporation shall not transcend the powers granted. 2d. The interest of the stockholders, that the capital shall not be subjected to the risk of enterprises not contemplated by the charter, and therefore not authorized by the stockholders in subscribing for the stock. 3d. The obligation of every one, entering in a contract with a corporation, to take notice of the legal limits of its powers.

These three reasons are clearly brought out in the unanimous judgment of this court, delivered by Mr. Justice Campbell, in the leading case of Pearce v. Madison and Indianapolis Railroad, 21 How. 441, in which it was held that a railroad corporation was not liable to be sued upon promissory notes

which it had given in payment for a steamboat received and used by it, and running in connection with its railroad. * * *

Ultra Vires Contracts.

CHICAGO, ETC., RY. CO. v. UNION PAC. RY. CO.

47 Fed. 15. 1891.

BREWER, J. * * * The doctrine of ultra vires has been thoroughly sifted within the last thirty years—its extent and limitations clearly defined. Thomas v. Railroad Co., 101 U. S. 71; Branch v. Jesup, 106 U. S. 468, 1 Sup. Ct. Rep. 495; Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co., 118 U. S. 290, 6 Sup. Ct. Rep. 1094; Oregon Ry. & Nav. Co. v. Oregonian Ry. Co., 130 U. S. 1, 9 Sup. Ct. Rep. 409; Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24, 11 Sup. Ct. Rep. 478. Two propositions are settled. One is that a contract by which a corporation disables itself from performing the functions and duties undertaken and imposed by its charter is, unless the state which created it consents, ultra vires. A charter not only grants rights—it also imposes duties. An acceptance of those rights is an assumption of those duties. As it is a contract which binds the state not to interfere with those rights, so, likewise, it is one which binds the corporation not to abandon the discharge of those duties. It is not like a deed or patent, which vests in the grantee or patentee, not only title, but full power of alienation; but it is more—it is a contract whose obligations neither party, state or corporation, can, without the consent of the other, abandon. The other is that the powers of a corporation are such, and such only, as its charter confers; and an act beyond the measure of those powers, as either expressly stated or fairly implied, is ultra vires. A corporation has no natural or inherent rights or capacities. Created by the state, it has such powers as the state has seen fit to give it —"only this, and nothing more." And so, when it assumes to do that which it has not been empowered by the state to do, its assumption of power is vain; the act is a nullity; the contract is ultra vires. These two propositions embrace the whole doctrine of ultra vires. They are its alpha and omega. * * *

Doctrine of Ultra Vires.

MINERS' DITCH CO. v. ZELLERBACH.

37 Cal. 543. 1869.

SAWYER, C. J. In considering the cases in which the law applicable to corporations is discussed, it must, also, always be borne in mind that there are several classes of rights to which they apply, and that upon the same general state of facts, the legal consequences might be different with reference to the different classes of rights. Thus there are corporate rights—that is to say, rights which pertain to the corporation as such—the artificial legal entity created by the act of incorporation, considered as a single, distinct person; individual rights of the stockholders as such, and rights of the creditors of the corporation. The rights of strangers dealing with the corporation may vary according as they are considered with reference to the corporation itself, the stockholders, or the creditors of the corporation. So also there are several classes of corporations, such as public municipal corporations, the leading object of which is to promote the public interest; corporations technically private, but yet of a quasi-public character, having in view some great public enterprise, in which the public interests are directly involved to such an extent as to justify conferring upon them important governmental powers, such as an exercise of the right of eminent domain. Of this class are railroad, turnpike and canal companies, and corporations strictly private, the direct object of which is to promote private interests, and in which the public has no concern, except the indirect benefits resulting from the promotion of trade, and the development of the general resources of the country. They derive nothing from the government, except the right to be a corporation and to exercise the powers granted. In all other respects, to the extent of their powers, they stand upon the footing of natural persons, having such property as they may legally acquire, and holding and using it ultimately for the exclusive benefit of the stockholders. In this last class, the stockholders and those dealing with the corporation are the only parties directly and immediately interested in their acts,

so long as the corporation confines itself within the general scope of its powers. The rights of the corporation, the corporators and of strangers dealing with the corporation, may, in some respects, vary according to the circumstances surrounding a given transaction.

The term ultra vires, whether with strict propriety or not, is also used in different senses. An act is said to be ultra vires when it is not within the scope of the powers of the corporation to perform it under any circumstances or for any purpose. An act is also sometimes said to be ultra vires with reference to the rights of certain parties, when the corporation is not authorized to perform it without their consent, or with reference to some specific purpose, when it is not authorized to perform it for that purpose, although fully within the scope of the general powers of the corporation, with the consent of the parties interested, or for some other purpose. And the rights of strangers dealing with corporations may vary, according as the act is ultra vires in one or the other of these senses. All these distinctions must be constantly borne in mind in considering a question arising out of dealings with a corporation. When an act is ultra vires in the first sense mentioned, it is generally if not always void in toto, and the corporation may avail itself of the plea. But when it is ultra vires in the second sense, the right of the corporation to avail itself of the plea will depend upon the circumstances of the case. * * *

The question, as between stockholders and the corporation, is a very different one from that which arises between the corporation itself and strangers dealing with it; and the principle established, where the contest arises between strangers and the corporation, is, whether the act in question is one which the corporation is not authorized to perform under any circumstances, or one that may be performed by the corporation for some purposes, but may not for others. In the former case the defense of ultra vires is available to the corporation as against all persons, because they are bound to know, from the law of its existence, that it has no power to perform the act. But in the latter case the defense may or may not be available, depending upon the question whether the party dealing with the corporation is aware of the intention to perform the act for an unauthorized purpose, or under circum-

stances not justifying its performance. And the test, as between strangers having no knowledge of an unlawful purpose and the corporation, is to compare the terms of the contract with the provisions of the law from which the corporation derives its powers; and if the court can see that the act to be performed is necessarily beyond the powers of the corporation for any purpose, the contract can not be enforced; otherwise it can. Or, in the language of Mr. Justice Selden, in the case before cited: "Where the want of power is apparent, upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defense of ultra vires is available against him. But such a defense would not be permitted to prevail against a party who can not be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts resting peculiarly within the knowledge of the corporate officers, then the corporation would, I apprehend, be estopped from denying that which (by assuming to make the contract), it had virtually affirmed." (22 N. Y. 290.) Strangers are presumed to know the law of the land, and they are bound, when dealing with the corporations, to know the powers conferred by their charter. These are open to their inspection, and it is easy to determine whether the act is within the scope of the general powers conferred for that purpose. But they have no access to the private papers of the corporation, or to the motives which govern directors and stockholders, and no means of knowing the purposes for which an act, that may be lawful for some purposes, is done. The very fact that the appointed officers of the corporation assume to do an act in the apparent performance of their duties which they are authorized to perform for the lawful purposes of the corporation, is a representation to those dealing with them that the act performed is for a proper purpose. And such is the presumption of the law, and upon this presumption, strangers having no notice in fact of the unlawful purpose, are entitled to rely. To this effect is the principle of the following, among other cases, as well as those already cited: Commissioners of Knox County v. Aspinwall, 21 How. (U. S.)

545, is a strong case applying this doctrine to public corporations. Gelpecke v. City of Dubuque, 1 Wallace (U. S.) 203, and cases cited; Bank of United States v. Danbridge, 12 Wheat. 64.

Upon any other principle there would be no safety in dealing with corporations, and the business operations of these institutions would be greatly crippled, while the interests of the stockholders and the public, and their general usefulness, would be seriously impaired. The officers are appointed by the corporation, and if any loss results to strangers dealing with the corporation from their misrepresentation in matters within the general scope of their duties, it should fall upon the corporation, which is responsible for their appointment, rather than upon parties who have no other means of ascertaining the facts, and must rely upon their assurances or not deal with the corporation at all. * * *

Executed Contracts.

LONG v. GEORGIA PACIFIC R. CO.

91 Ala. 519, 8 So. 706. 1890.

McCLELLAN, J.—The case made by the amended bill is this: On April 23, 1883, the complainant, B. M. Long, and his wife, Amanda C. Long, executed to the Georgia Pacific Railway Co. a deed upon valuable consideration presently paid, to and of the iron, coal and oil interests and properties in and pertaining to certain tracts of land, aggregating about four thousand acres; the said Long retaining the fee to said lands, except in respect to said mineral interests, and continuing in possession thereof. The grantee is a corporation, and was and is without power to purchase and hold said land, or the mineral interests in the same. The bill seeks to have the deed declared void, because of this incapacity of the corporation, and to have the same cancelled as a cloud upon complainant's title. The bill was demurred to on several grounds, and the demurrer was sustained generally, the decree to that end being now assigned as error.

Only those grounds of error which present the question,

whether a vendor who has sold, received payment for, and conveyed land to a corporation, which had no power to hold the same, can have any relief in respect to the transaction, are discussed in argument; and to these our consideration will be confined, since it is manifest that the determination of this question, in line with the decree below, as we think it must be determined, will be fatal, not only to the present appeal, but to complainant's cause of action.

It is thoroughly well settled law, that a party to an ultra vires executory contract made with a corporation is not estopped to set up the want of corporate capacity in the premises, either by the fact of contracting, whereby the power to contract is, in a sense, admitted or recognized, or by the fact that the fruits or issues of the contract have been received and enjoyed; and this, though the assault upon the transaction comes from the corporation itself—Marion Savings Bank v. Dunklin, 54 Ala. 471; Chambers v. Falkner, 65 Ala. 448; Sherwood v. Alvis, 83 Ala. 115; Chewacla Lime Works v. Dismukes, 87 Ala. 344. But, where the contract is fully executed—where whatever was contracted to be done on either hand has been done—a different rule prevails. In such case, the law will not interfere, at the instance of either party, to undo that which it was originally unlawful to do, and to the doing of which, so long as the contract to that end remained executory, neither party could have coerced the other. As declared by Mr. Bishop, "the parties voluntarily doing of what they have unlawfully agreed, places them, in effect, in the same position as if the contract had been originally good; neither can recover of the other what was parted with. The reason for which is, that, since they are equally in fault, the law will help neither."—Bishop on Contracts, § 627.

The former decisions of this court are in line with this doctrine, and fully recognize the distinction between executory and executed void contracts, to the effect that, while suits to enforce the former may always be defended on the ground of their invalidity, no relief prayed upon such ground can be granted with respect to the latter.—Morris v. Hale, 41 Ala. 510; Ingersoll v. Campbell, 46 Ala. 282; Sherwood v. Alvis, 83 Ala. 115; Dudley v. Collier, 87 Ala. 431; Craddock v. Mortgage Co., 88 Ala. 281. And this is the doctrine generally declared

by other courts—Thomas v. Railroad Co., 101 U. S. 71; Day v. S. S. B. Co., 57 Mich. 146; s. c. 52 Amer. Rep. 352; Parish v. Wheeler, 22 N. Y. 494; Miners' Ditch Co. v. Tellerbach, 37 Cal. 542, 606; Terry v. Eagle Lock Co., 47 Conn. 141.

There is no question but that the case presented by the bill involved a contract on the part of the railway company to buy, and on the part of the complainant to sell, certain interests in the land described. It is equally clear that the payment of the agreed price on the one hand, and the execution of the conveyance on the other, fully executed this contract on both sides, left nothing to be done by either party in the premises, and bring the transaction within the principle we have been considering, which denies to the complainant any relief in respect to it.

The same conclusion is reached by another well established principle. It is, that when a party sells and conveys property to a corporation, which is without power to purchase and hold the same, and receives compensation therefor, there being no fraud in the transaction, he is in no sense injured or prejudiced by the incapacity of the corporation, nor can he be heard to complain of it; but the question becomes one between the corporation and the State, the sovereign alone having the right to impeach the transaction; and until it supervenes for this purpose, the corporation is vested with perfect title against all the world, defeasible only on office found.—R. & B. Railroad Co. v. Proctor, 29 Vt. 93; Leazure v. Hillegas, 7 Serg. & Rawle, 313; Goundie v. Northampton Water Co., 7 Pa. St. 233; Baird v. Bank of Washington, 11 Serg. & Rawle, 411; Lathrop v. Bank, 8 Dana, 114, 129; Hough v. Cook County Land Co., 73 Ill. 23; s. c., 24 Amer. Rep. 230; Cowles v. Springs Co., 100 U. S. 55; Reynolds v. Crawfordsville Bank, 112 U. S. 405, 413; 2 Mor. Corp. § 710. Affirmed.

Partially Executed Contracts.

WHITNEY ARMS CO. v. BARLOW.

63 N. Y. 62. 1875.

(The American Seal and Lock Co., a corporation organized under the general manufacturing act of New York, entered

into a contract with plaintiff, the Whitney Arms Co., a corporation organized in Connecticut "for the purpose of manufacturing every variety of fire-arms and other implements of war, caps, cartridges, balls and like munitions of war applicable to the use of fire-arms, and all kinds of machinery adapted for the construction thereof and otherwise," by which the latter company agreed to manufacture and deliver 20,000 railroad locks to be paid for sixty days after delivery. Plaintiff made and delivered 10,000 locks under the contract when, by mutual agreement, the contract was rescinded as to the residue. The American Seal & Lock Co. gave two notes for the purchase price, and having failed to pay these notes, this action was brought against the defendants as trustees to enforce their statutory liability for indebtedness of the corporation.)

ALLEN, J.—* * * It must be conceded that the manufacturing and vending of "railroad locks" is not within the purposes for which the plaintiff was incorporated, or within the powers conferred by its charter. Neither is such business incidental to the purposes of the incorporation, or in any way necessary to, or as far as appears even an aid in the exercise of the powers conferred upon the plaintiff by its constitution, so that it could be regarded as among the implied powers granted by the legislature and assumed by the corporators.

Did the question now made arise upon an application by the stockholders and corporators to restrain the corporate agents from applying the corporate funds to purposes foreign to the corporation, or engaging in business outside of that for which the company was formed, or on proceedings by the sovereign power to annul the charter for an abuse of the powers granted, or in a proceeding to enforce and for the performance of an executory contract, where, upon a rescission or annulling the agreement, both parties would have the same position as if no contract had been made, the rules of decision would be different from those which must prevail in the present action. In either of the cases suggested it is very likely the courts would be compelled to give full effect to the objection and hold the business unauthorized and a violation of the charter, and a forfeiture of the chartered rights and the contract null, and refuse to perform it or give effect to it. The manufacture of

the locks, or contract to sell them to the Seal Lock Company, were not acts immoral in themselves or forbidden by any statute, neither mala in sese or mala prohibita, so as to make the contract illegal and incapable of being the foundation of an action; such a contract as the law will not recognize or enforce, but applying the maxim, *ex facto illicito non oritur actio,* leave the parties as it finds them.

When acts of corporations are spoken of as ultra vires, it is not intended that they are unlawful or even such as the corporation cannot perform, but merely those which are not within the powers conferred upon the corporation by the act of its creation, and are in violation of the trust reposed in the managing board by the shareholders, that the affairs shall be managed and the funds applied solely for carrying out the objects for which the corporation was created. (Earl of Shrewsbury v. North Staffordshire R. Co., L. R. 12, 1 Ep., 593; Taylor v. Chichester and Midhurst R. Co., L. R., 2 Exch., 356; Bissell v. Mich. C. R. Co., 22 N. Y. 258.)

Whether the contract as originally made was ultra vires is not a very important inquiry at this time. If it was, the State under whose sovereignty it dwells and by whose act and favor it exists, has no interest in arresting its action for the recovery of moneys equitably due upon a contract fully executed and a work fully accomplished, whatever may be its right to annul its charter. The shareholders, whose confidence has been abused and whose funds have been diverted from their proper use, have a direct interest in reclaiming and restoring to proper custody and applying to legitimate uses the funds which have been diverted and improperly used for purposes dehors the legitimate business of the corporation. The plea of ultra vires should not as a general rule prevail, whether interposed for or against a corporation, when it would not advance justice, but on the contrary would accomplish a legal wrong.

Here, as between two corporations, the debtor and creditor corporation, the contract has been fully performed by the creditor, the plaintiff in this action, and the Seal Lock Company has received the full consideration of its promise to pay. The plaintiff has parted with its property to the latter corporation, and unless a legal liability exists on the part of the latter to pay, the plaintiff can neither reclaim the property or

recover compensation, and under this technical plea a great wrong will be perpetrated. A purchaser who acquired by contract, and under an agreement to pay for it, the property of a corporation, cannot defeat the claim for the purchase-price by impeaching the right of the corporation to become the owner of the property. One who has received from a corporation the full consideration of his engagement to pay money, either in services or property, cannot avail himself of the objection that the contract thus fully performed by the corporation was ultra vires, or not within its chartered privileges and powers. It would be contrary to the first principles of equity to allow such a defense to prevail in an action by the corporation.

It is now very well settled that a corporation cannot avail itself of the defense of ultra vires when the contract has been, in good faith, fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract. If an action cannot be brought directly upon the agreement, either equity will grant relief or an action in some other form will prevail. The same rule holds e converso. If the other party has had the benefit of a contract fully performed by the corporation, he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation. (Ex parte Chippendale, 4 D. G., M. & G., 19; In re National P. B. Build. Soc., L. R., 5 Chy. Appeals, 309; In re Cork, etc., R. C., 4 id., 748; Fishmongers Co. v. Robertson, 5 McG., 131.)

The only justification for such a plea by an individual sued upon a contract with a corporation is, that the obligation is not mutual, as the other party, the corporation, would not be bound by it. The objection to such a defense in an action upon an executed contract is given by Tindal, Ch. J., in the case last cited, in these words: "Upon the general ground of reason and justice, no such answer can be set up. The defendants having had the benefit of the performance by the corporation of the several stipulations into which they entered, have received the consideration for their own promises; such promise by them is, therefore, not nudum pactum; they never can want to sue the corporation upon the contract in order to enforce the performance of their stipulations which have been already

voluntarily performed, and therefore no sound reason can be suggested why they should justify their refusal to perform the stipulations made by them on the ground of inability of the corporation, which suit they can never want to sustain."

The same principle was adjudged in R. and B. R. Co. v. Proctor (29 Vt. 93), Ch. J. Redfield saying: "The only wrong in the directors is in having exceeded their powers; the transaction with the defendants, so far as it goes, will tend to restore a portion of the money to its rightful proprietor, and of this the defendants ought not to complain as they are confessedly solicitous to bring the directors of the plaintiff's company back to their legitimate functions." (See, also, Farmers' and Millers' Bank v. D. and M. R. Co., 17 Wis., 372.)

The same equitable principle was intimated by Ch. J. Kent, in Silver Lake Bank v. North (4 J. Ch., 370). Parish v. Wheeler (22 N. Y., 494), proceeds and was adjudged upon this general rule, Ch. J. Comstock, enunciating the doctrine that "the executed dealings of corporations must be allowed to stand for and against both parties, where the plainest rules of good faith require."

Palmer v. Lawrence (3 Sandf. Sup. Ct. R., 161), lays down the proposition in more comprehensive terms. Judge Duer, speaking for the court, says: "The general rule which is fairly deducible from all the cases on this subject is, that a defendant who has contracted with a corporation de facto is never permitted to allege any defect in its organization as affecting its capacity to contract or sue." The proposition may not be true in respect to contracts executory and wholly unexecuted; we do not pass upon that. It was decided in the Steam Navigation Co. v. Weed (17 Barb., 378), that when it was a simple question of capacity to contract arising either on a question of regularity of organization or of powers conferred by the charter, a party who has had the benefit of the contract cannot be permitted, in an action founded upon it, to question its validity. Judge Parker's opinion, to which nothing need be added, is well fortified by the many cases to which he refers and which, aside from the argument of the learned judge, abundantly sustain the judgment. Among the cases referred to and commented upon by Judge Parker, are Silver Lake Bank v. North (supra); State of Indiana v. Woram

(6 Hill, 37); Chester Glass Co. v. Dewey (16 Mass., 94); Steamboat Co., v. McCutcheon (13 Penn. St. R., 13).

It is very evident, as well upon principle as upon authority, that had this action been against the debtor corporation the objection that the contract was not authorized by the charter of the plaintiff would have been untenable and the plaintiff would have been entitled to recover. * * *

When it is proved that the corporation has received property from others under a promise to pay, under circumstances which the law would adjudge sufficient to charge the corporation for the purchase-price, a debt is established which the trustees cannot dispute, although perchance the corporation might, for any reason, have refused to accept the property; and had it done so no legal liability would have resulted. * * *

CHAPTER IX.

CORPORATE CRIMES AND TORTS.

Liability of Corporations for Torts.

EASTERN COUNTIES RAILWAY CO. AND RICHARDSON v. BROOM.

6 Exch. (Welsby, H. & G.) Reports 314 (Eng.); 2 Eng. L. & Eq. 406. 1851.

Broom, a passenger on the railway, brought an action of trespass for assault, battery and false imprisonment, against the company, and Richardson, its inspector. The plaintiff's evidence showed that he was a passenger in defendant's car, that he was assaulted in the car, forcibly taken out of the same, and imprisoned by Richardson, then an inspector in the service of the company, professing to act in so doing as its servant, and under assertions of justification which the evidence failed to establish. The court, in leaving the evidence to the jury, said the company could be liable in one of two ways: "If, beforehand, they gave instructions to their servants to remove from their cars any who disobeyed the by-laws, and commit him to a policeman, if they gave their directions generally, there was no doubt they would be liable. They would also, if, discovering that their servant, acting on their behalf, had given the plaintiff into custody, they adopted the act, and directed their attorney to follow that up and prosecute the charge." This was objected to, and it was contended that an action of trespass for assault and battery does not lie against a corporation aggregate; that in order to render the corporation liable for such an act by an agent, the authority to do the act must be given by an instrument under seal; and that such authority must precede the act, since the corporation can not be rendered liable by ratification.

PATERSON, J. I have conferred with my learned brothers upon this case, and we are all of opinion that there is no reason

why we should defer our judgment. The first question arises on the declaration itself, and is quite independent of the particular circumstances of this case. It is alleged on the part of the plaintiffs in error, as a general broad proposition of law, that in no case can an action of trespass for assault and battery lie against a corporation aggregate. Whatever may be the effect of the authorities in the Year Books, it has been expressly held, in modern times, that trespass will lie against a corporation aggregate for breaking and entering a close, and for seizing goods. This has been decided by several recent cases. Then the question is whether trespass for assault and battery may lie against a corporation, and it has been contended that it can not, for it is said that it can neither beat nor be beaten. No doubt that proposition is true of it as respects its corporate capacity. But it does not, therefore, follow that if a corporation, by authority under seal, direct a servant to apprehend and imprison a particular person, an action for assault and battery can not be maintained against the corporation. The learned counsel who appears for the plaintiffs in error must contend, in order to show that this declaration can not be supported, that no such action would lie. But we are all clearly of opinion that it is not so, and that an action of trespass for assault and battery will lie against a corporation whenever the corporation can authorize the act done, and it is done by their authority. We are, therefore, of opinion that the declaration is good; and we do not think it necessary to go through the several authorities upon this question. The next question is whether, in order to render the corporation liable for the act of their servant, it was necessary that that servant should have an authority by deed. It has been decided, many years ago, that a corporation may be liable in tort for the acts of their servants, although their authority be not under seal. It is not necessary, therefore, further to advert to this point.

With respect to the point, whether the company could ratify the act, if the act can be said to have been done for the use or benefit of the company, there can be no doubt that they could ratify it. The assault and imprisonment of a party liable to the company for not having paid his fare was an act of the servant of the company, which manifestly might have

been for the benefit of the company. Therefore, we are clearly of the opinion that there might have been a ratification of that act. The law is well laid down in distinct terms in the passage from the 4th Inst. 317, "He that receiveth a trespasser, and agreeth to a trespass after it be done, is no trespasser, unless the trespass was done to his use or for his benefit, and then his agreement subsequent amounteth to a commandment." The question of liability by ratification depends upon this, whether the act was originally intended to be done to the use or for the benefit of the party who is afterwards said to have ratified it. We are with the plaintiff in this case, that the action might lie, and the act, though not done with the knowledge of the company in the first instance, might have been ratified by them; but we are of opinion that there was no evidence of any such ratification, and that the direction of the lord chief baron was wrong in this respect. The result, therefore, is that there must be a venire de novo. Venire de novo.

Liability for Tort of Assault.

BROKAW v. NEW JERSEY R. ETC. CO.

32 N. J. Law 328, 90 Am. Dec. 659. 1867.

DEPUE, J. The declaration in this case charges that the New Jersey Railroad and Transportation Company, by their servants, and William Campbell, the other defendant, with force and arms assaulted the plaintiff, and ejected and expelled him from a certain car in which he was riding on the New Jersey railroad, and wounded, bruised and ill treated him.

To this declaration the defendants have filed a general demurrer, and upon the argument two questions were raised: 1. Whether an action of trespass for an assault and battery can be maintained against a corporation; and 2. Whether in such action an individual can be joined as a co-defendant with a corporation. * * *

The second ground of demurrer is that William Campbell is joined as a defendant with the New Jersey Railroad and Transportation Company. The joinder is proper; for in trespass all the actors are principals, and may be joined in one suit; and

an individual and a corporation may be joined as defendants in the same suit. 1 Vin. Abr., tit. Abatement, Z, p. 32; Brown on Corporations, pl. 24.

Both the defendants are charged as principals, and it does not appear that Campbell was the servant of the company, and if it did the joinder would still be proper. A joint action of tort in the nature of trespass may be maintained against a corporation and its servants for a personal injury inflicted by the latter, in discharging the duties imposed on him by the corporation. Hewett v. Swift, 3 Allen 420; Moore v. Fitchburg R. Co., 4 Gray 465 (64 Am. Dec. 83).

In considering this case we have not overlooked the case of Orr v. Bank of the United States, 1 Ohio 36 (13 Am. Dec. 588), which was much relied on by the defendants' counsel. That case proceeds on principles long since obsolete, and is against all the later authorities.

The demurrer is overruled.

Liability for Tort Involving Malice.

VANCE v. ERIE RAILROAD CO.

32 N. J. Law 334. 1867.

On demurrer to the declaration. Argued at June term, 1867, before the chief justice, and Justices Vredenburgh, Woodhull, and Depue.

The opinion of the court was delivered by

DEPUE, J.—This action is an action of trespass on the case for malicious prosecution. To the plaintiff's declaration, the defendants have filed a general demurrer and upon the argument various grounds of demurrer were urged, all of which have been disposed of in the opinion delivered at the present term, in Brokaw v. The New Jersey R. Co., 32 N. J. Law 328, except the specific objection, that an action for malicious prosecution cannot be maintained against a corporation. It is argued by counsel, that a corporation, being an ideal entity, is incapable of entertaining malice, which is an intent of the mind, and is an essential ingredient of an action for malicious prosecution.

We have seen, by the cases cited in Brokaw v. The New Jersey Railroad and Transportation Co., that a corporation is liable for false and fraudulent representations, for maliciously obstructing a party in his business, for maintaining a vexatious suit, and for a malicious libel, in each of which actions an intent of the mind is quite as much involved as in an action for malicious prosecution.

In Stevens v. Midland County Railway Co., 10 Exch. 352, the question whether an action for malicious prosecution would lie against a corporation was mooted in the Court of Exchequer, and Alderson, B., expressed an opinion that it would not lie, assigning as a reason, that in order to support the action, it must be shown that the defendant was actuated by a motive of the mind, and that a corporation has no mind. Platt, B., was of the opinion, that there was no evidence that the corporation had authorized the prosecution; and upon the point whether the action would lie, said: "But I do not say that a case might not arise, in which a motive might be assigned, upon which the action could be maintained." Martin, B., the only other judge who sat on the cause, concurred with Platt, B., as to the insufficiency of the evidence, and declined to give any opinion on the question, whether the action could be maintained.

In Whitfield v. S. E. Railway Co., E. B. & E. 113, which was an action against a corporation for a malicious libel, the declaration was demurred to for the same reason that has been assigned here, and the opinion of Alderson, B., was cited by counsel, in support of the demurrer. The demurrer was overruled, and Lord Campbell, in delivering the opinion of the court, said, "but, considering that an action of tort or of trespass will lie against a corporation aggregate, and that an indictment may be preferred against a corporation aggregate, both for commission and omission, to be followed up by fine, although not by imprisonment, there may be great difficulty in saying that, under certain circumstances, express malice may not be imputed to, and proved against, a corporation."

In Green v. The London Omnibus Co., 7 C. B. N. S. 290, which was an action for wrongfully, vexatiously, and maliciously obstructing and annoying the plaintiff in his trade, on demurrer to the declaration, it was urged that the action could

not be maintained, on the same ground that malice was the gist of the action, and that a corporation cannot, as such, be actuated by malice. The declaration was sustained, and Erle, C. J., in delivering the opinion of the court, disposed of the argument of the counsel with the remark, that the doctrine relied on—that a corporation, having no soul, cannot be actuated by malice—is more quaint than substantial.

The same argument was addressed to the Supreme Court of the United States, in Philadelphia, W., & B. R. Co. v. Quigley, 21 How. 202, which was an action against a corporation for a libel, and was by that court repudiated, as a reason for exempting a corporation from liability for a libelous publication.

If actions for malicious libel—for vexatious suits, for vexatiously and maliciously obstructing another in his business, for wilful trespasses, and for assault and battery, in each of which the motives and intent of the mind are directly involved—can be maintained against a corporation aggregate, no reasons, founded on principle, can be suggested why an action for malicious prosecution should not also be sustainable against a corporation.

The reasons assigned by Erle, C. J., in Green v. London Omnibus Co., for holding a corporation answerable for vexatious and malicious interference with the business of another, the extreme mischief and inconvenience which would follow from holding companies incorporated for the purpose of carrying on trade exempt from liability for intentional acts of wrong, and driving those they have injured to seek a doubtful remedy against their officers or servants, who may be wholly unable to answer the compensation which the jury may award, apply with equal force to actions for malicious prosecution.

When the nature of the action is considered, it comes strictly within the principles by which the actions above enumerated are maintainable. It must appear that the prosecution was instituted maliciously, and without probable cause. In a legal sense, any act done wilfully, to the injury of another, which is unlawful, is, as against that person, malicious and it is not necessary that the perpetrator, of such act should be influenced by ill will toward the individual, or that he entertain and pursue any bad purpose or design. Carr v. Snelling, 15 Pick.

337; 2 Greenl. Ev., § 453. The proof of malice need not be direct. It may be inferred by the jury, from the want of probable cause, 2 Greenl. Ev., § 453, per Lord Campbell, in Whitfield v. S. E. Railway Co., and involves nothing more than a wrongful act intentionally done.

To hold a corporation amenable to this particular action, is strictly in accordance with well-settled legal principles. The wrong for which the action is the appropriate remedy, is susceptible of being committed by a corporation, by means of its agents and servants. No technical difficulties are in the way of the institution of the suit, and, at the trial, the cause can be conducted upon the established rules of evidence. To afford redress against a corporation for other intentional wrongs done by them, and deny it in this case, is an anomaly which can only be justified because of the interposition of insurmountable obstacles. No such obstacles stand in the way of the prosecution or maintenance of the action.

Under what circumstances a corporation is liable for the tortious acts of its servants or agents, even when done in obedience to the orders of its directors or officers, has been considered, in the case of Brokaw v. The New Jersey Railroad and Transportation Co., supra. Whether, in this case, the servants or agents of the defendants, in making the arrest complained of, were acting by the authority of the corporation, is a question to be determined at the trial, in accordance with the rules stated in that case.

Demurrer overruled.

Liability for Crimes Involving Malicious Intent.

STATE v. ATCHISON.

3 Lea 729 (Tenn.), 31 Am. Rep. 663. 1879.

FREEMAN, J. This is an indictment for libel, quashed in the court below and appealed by the state. The indictment has two counts, the first against Atchison and Buck, the second against the Banner Publishing Company. The matter alleged is the same in both counts.

Having found the matter libelous, the court said: * * *

It is next objected that the joinder of two different counts against two different parties is error, for which the indictment should have been quashed. In the case of the State v. Lea, there was one count against Polly Bailey for perjury, and a second against Lea for subornation of perjury. The court say: "We are unable to perceive why these parties were not properly joined in the same indictment, and charged in separate counts, though their offenses be distinct. They were of the same nature, admitted of the same plea and same judgment." 1 Cold. 177. So, in this case, the offense is precisely the same —the same plea is appropriate. It is true the corporation may not be imprisoned, but the fact that the same measure of punishment can not be inflicted in this way can not vitiate the indictment; the judgment is of the same character, that is, a fine and costs. That imprisonment might possibly be inflicted in one case and not in the other, can not in the least affect the validity of the indictment. The principal of such an objection is that joinder of different offenses might embarrass the parties in their defense. The fact that one could not be imprisoned after conviction, certainly can have no influence in the conduct of the trial on the question of guilty or not guilty.

We see no ground on which the judgment can be sustained, and reverse it, remanding the case for further proceedings.

CHAPTER X.

DIRECTORS—HEREIN ALSO OF OFFICERS AND AGENTS.

Functions of Directors—Definition.

METROPOLITAN ELEVATED R. CO. v. MANHATTAN ELEVATED R. CO.

11 Daly 373 (N. Y.). 1884.

VAN BRUNT, J. * * * That the directors of a corporation are agents seems to be clearly recognized in all the cases in which the relations of directors and shareholders to their corporation have been discussed.

It is said in Twin Lick Oil Co. v. Marbury (91 U. S. 587, 589) that the directors are the officers or agents of the corporation, and represent the interests of that abstract legal entity, and of those who own the shares of its stock.

In Cumberland Coal, etc., Co. v. Sherman (30 Barb. 553, 571) the court says: "There can be no question at the present time that a director of a corporation is the agent or trustee of the stockholders."

In Angell & Ames on Corporations, § 771, it is stated that "The stockholders compose the company, and the managers, directors or officers are their agents, necessary for the management of the affairs of the company, but they are not essential to its existence as such, not forming one of the integral parts."

In Abbott v. American Hard Rubber Co. (33 Barb. 578) the court says, at the foot of page 591: "Boards of directors are agents of the corporation to manage its affairs and carry out the purpose and object of its formation."

The directors thus being the agents of the corporation, what are their powers and whence are they derived, and how must corporate powers residing in the corporation, the right to exercise which is not vested in the directors, be brought into opera-

tion? These questions are so intimately connected that they must be disposed of together.

The powers of directors are such as are conferred by the charter of their corporation and the laws pertaining thereto, and such corporate powers as are not conferred by law upon the directors remain in the corporation to be exercised, or at least set in motion by its component parts, the shareholders.

In the case at bar the charter provided that the directors were to manage the business and affairs of the company; and the question involved in this branch of the case is whether this language conferred the right to exercise every corporate power possessed by the corporation or merely to manage the ordinary business and affairs of the company for the carrying on of which it was organized, leaving the right remaining in the shareholders composing the company to set in motion or confirm corporate action within the limits of its powers, but extraordinary and unusual in its nature.

Within the sphere of their duties the right of the directors is undoubtedly exclusive, and, further, all corporate acts must be done through them, as they are exclusive executive and administrative authority, but, nevertheless, all corporate powers do not reside in the board of directors.

It is true that the court says, in McCullough v. Moss (5 Denio 567, 575), that: "When a charter invests a board with the power to manage the concerns of a corporation the power is exclusive in its character. The corporators have no right to interfere with it, and courts will not, even on a petition of a majority, compel the board to do an act contrary to its judgment."

That case was an action to recover upon a promissory note, which the corporation in the exercise of its legitimate business could have made, and the question presented was whether execution was proved. The note was signed by the president and secretary of the company, but no authority from the board of directors, who, by the charter, were to conduct the affairs of the company, to the president and secretary, was shown. Some resolution of the shareholders was shown, but it had no relation to this question, and then the court uses the language above quoted. This case nowhere decides that the directors are clothed with all the corporate powers. It may

be cited as an authority for the proposition that the shareholders can not compel the directors to act in any manner against their judgment in the exercise of a corporate power which remains in the corporation.

For example, if the power to lease was vested in the corporation, but the directors could not, because of the limitation in the charter, exercise this power, the shareholders could not cause the lease to be executed and delivered, nor could they compel the directors to execute and deliver the same against their own judgment; all that the shareholders could do would be to authorize the directors to act or confirm an act of the directors which would be incomplete without such ratification.
* * *

After an examination of the reasoning in all the adjudicated cases (which has been by no means cursory), after a consideration of the principles governing the relations of shareholders of a corporation and its directors, conceding that a corporation can do no act unless specially authorized thereto, except through its board of directors, I am irresistibly brought to the conclusion that acts making organic or fundamental changes in the character or business of the corporation, can not be done either by the directors alone, or by the shareholders alone; but that both the executive and administrative officers of the corporation must unite with the shareholders of the corporation, who confer the right to act upon the individuals intrusted with the office of directors; that directors are merely temporary officers of the corporation, by virtue of their office entitled to manage the business and affairs of the corporation during their term of office, without interference from the stockholders, but they can not say that a new board of directors, although duly elected by the stockholders, shall never thereafter interfere with the management of the properties of the corporation, because they have placed their possessions and management into other hands forever.
* * *

Judgment for plaintiff.

Powers of Directors.

CHICAGO CITY R. CO. v. ALLERTON.

18 Wall. 233 (U. S.). 1873.

Appeal from the Circuit Court for the northern district of Illinois; the case being thus:—

The Chicago City Railway Company was a corporation owning a street railroad in Chicago. The directors of the company, without consulting the stockholders or calling a meeting of them, resolved to increase the capital stock of the company from $1,250,000 to $1,500,000. To this one Allerton, who was a stockholder, objected, and filed a bill praying for an injunction to prevent the increase. * * *

The railway company, in its answer, relied upon its charter, granted February 14th, 1859, the third and fourth sections of which were as follows:

"Section 3. The capital stock of said corporation shall be one hundred thousand dollars, and may be increased from time to time, at the pleasure of said corporation.

"Section 4. All the corporate powers of said corporation shall be vested in and exercised by a board of directors, and such officers and agents as said board shall appoint."

The position of the company was that the third section conferred an unrestricted right to increase the capital stock at will, and that the fourth vested this power in the board of directors, and that the constitutional provision and act above referred to, if applied to this corporation, would impair the validity of the contract. The court decreed in favor of the complainant and the company took the present appeal.

BRADLEY, J., delivered the opinion of the court.

Without attempting to decide the constitutional question, or to give a construction to the act of the legislature, we are satisfied that the decree must be affirmed on the broad ground that a change so organic and fundamental as that of increasing the capital stock of a corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless expressly authorized thereto. The general power to perform all corporate acts refers to the ordinary business transactions of

the corporation, and does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock. A corporation, like a partnership, is an association of natural persons who contribute a joint capital for a common purpose, and although the shares may be assigned to new individuals in perpetual succession, yet the number of shares and amount of capital cannot be increased, except in the manner expressly authorized by the charter or articles of association.

Authority to increase the capital stock of a corporation may undoubtedly be conferred by a law passed subsequent to the charter; but such a law should regularly be accepted by the stockholders. Such assent might be inferred by subsequent acquiescence; but in some form or other it must be given to render the increase valid and binding on them. Changes in the purpose and object of an association, or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character, and cannot, on general principles, be made without the express or implied consent of the members. The reason is obvious.

First, as it respects the purpose and object. This may be said to be the final cause of the association, for the sake of which it was brought into existence. To change this without the consent of the associates, would be to commit them to an enterprise which they never embraced, and would be manifestly unjust.

Secondly, as it respects the constituency, or capital and membership. This is the next most important and fundamental point in the constitution of a body corporate. To change it without the consent of the stockholders, would be to make them members of an association in which they never consented to become such. It would change the relative influence, control, and profit of each member. If the directors alone could do it, they could always perpetuate their own power. Their agency does not extend to such an act unless so expressed in the charter, or subsequent enabling act; and such subsequent act, as before said, would not bind the stockholders without their acceptance of it, or assent to it in some form. Even when the additional stock is distributed to each stockholder pro rata, it would often work injustice, because many of the stockholders might be unable to take their respective shares, and might thus

lose their relative interest and influence in the corporate concern.

These conclusions flow naturally from the character of such associations. Of course, the associates themselves may adopt or assent to a different rule. If the charter provides that the capital stock may be increased, or that a new business may be adopted by the corporation, this is undoubtedly an authority for the corporation (that is, the stockholders) to make such a change by a stockholders' vote, in the regular way. Perhaps a subsequent ratification or assent to a change already made would be equally effective. It is unnecessary to decide that point at this time. But if it is desired to confer such a power on the directors, so as to make their acts binding and final, it should be expressly conferred.

Where the stock expressly allowed by a charter has not been all subscribed, the power of the directors to receive subscriptions for the balance may stand on a different footing. Such an act might, perhaps, be considered as merely getting in the capital already provided for the operations and necessities of the company, and, therefore, as belonging to the orderly and proper administration of the company's affairs. Even in such case, however, prudent and fair directors would prefer to have the sanction of the stockholders to their acts. But that is not the present case, and need not be further considered.

Decree affirmed.

Director's Duty of Diligence.

GIBBONS v. ANDERSON.

80 Fed. 345. 1897.

SEVERENS, J. The bill in this case was filed by the complainant, as receiver of the City National Bank of Greenville, to establish the liability of the defendants, Foster and Anderson, who were directors of the bank, for negligence in the performance of their duties as such, which it is alleged has resulted in a heavy loss to the bank and its creditors. The bank was organized April 28, 1884, with a capital stock of $50,000. It was suspended on the 22d day of June, 1893. The com-

plainant was appointed receiver thereof by the comptroller of the currency five days later, and on July 1, 1893, entered upon the discharge of his duties. The total liability of the bank to its creditors at the time of its failure was $237,733. The nominal value of its assets was about $326,000, but the total net amount which the receiver has been able to realize from the assets is only about $40,000. This result is certainly a very startling one, and the enormous loss in the liquidation of the bank's assets calls for an inquiry for its causes. And they are not far to seek. The defendants were members of the board of directors from its organization to the date of its suspension. Le Roy Moore was another director, and, either in the capacity of cashier or president, was its managing officer during the whole of the bank's operations. If during part of the time another person was cashier, he was only nominally such. Moore dominated the bank, and exercised the functions of cashier. Upon investigation it turns out that substantially from the beginning Moore employed the bank for the promotion of his own business enterprises, and, to a steadily increasing amount, has in one way and another diverted its funds to his own use, to the extent that at the date of the suspension of the bank he was indebted to the bank upon paper of which he was the maker in the sum of $36,263.63, and as indorser in his own name in the sum of $44,819.59. He was also liable as indorser under the name of Le Roy Moore & Co. in the sum of $17,419.97. No other person than Le Roy Moore was liable for these indorsements of Le Roy Moore & Co.; the other member having long since been discharged by the renewal of paper and the extension of credit without his knowledge,—that firm having been dissolved in 1887, and the liabilities thereof assumed by Moore. There was also in the bank at the time of its suspension, representing part of its assets, paper upon which the Stanwood Manufacturing Company was maker to the amount of $8,750, and upon which it was indorser, $67,748.54, amounting in all to $76,498.54. This Stanwood Manufacturing Company was a business concern of which Moore was the owner, with a trifling exception. He owned 2,400 of the 2,500 shares of $10 each, and, so far as appears, only 20 other shares were taken. The books of the company show that $15,000 only of its capital stock were paid in, and this by Le Roy Moore's

individual promissory notes, upon which he never made any payment. The bank had a chattel mortgage on all its property, and the sum of $3,500 was the sum realized out of the sale of that property under this mortgage. Over $63,000 of paper held by the bank, upon which the Stanwood Manufacturing Company was indorser, consisted of accommodation notes made by the employes about the factory of the Stanwood Manufacturing Company, and was worthless. This paper was all unloaded upon the bank by Moore in the prosecution of his own enterprises, and operated practically as a credit to himself. For a number of years prior to the suspension of the bank he was a borrower from it, either upon his own name, or under a guise so thin as to be transparent, to an amount grossly in excess of the legal limit. The comptroller in his letter of October 14, 1892, states that at the last examination he was directly indebted to the bank in the sum of $29,565. In all these ways, direct and indirect, Moore converted the assets of the bank to his own use, and in the end it appears that for all these large sums which Moore had obtained, and which were represented by paper which he had employed for that purpose, amounting to $172,768.88, only a very little can be realized. Moore made a trust deed of all his property to secure the debts he owed to the bank, out of which not more than $12,000 to $15,000 can be realized. This is the result, not of a single fraud, nor of a group of contemporaneous frauds, practiced by Moore, but, as already stated, it is the consequence of malversation of the funds of the bank from about the beginning of its history. It is needless to go into detail. The books of the bank show that he was going deeper and deeper into the funds of the bank, and, under one cover or another, converted of its assets more than three times the amount of its capital stock. The defendants, who were directors all this time, say that they were ignorant of anything wrong in the affairs of the bank until their eyes were opened to the facts by its failure. Greenville is a small place, of only about 3,000 inhabitants, and the defendants resided there. The volume of the business of the bank was comparatively small,—certainly not so large but that the most cursory examination of the general features of its business by any one having ordinary business intelligence would have disclosed the truth. It is contended by the direct-

ors that they did not in fact know how Moore was carrying the substance out of it, and it is the more charitable view to take of their conduct to the extent that supine negligence is more easily excused than active fraud. There is in the record the testimony of witnesses stating that at the time of the failure of the bank these defendants declared that they trusted all to the president, and that they knew but little of the bank's affairs, relying as they did upon their confidence in the management. But what else can be said than that, if they had notice of the facts, they were culpable, or that, if they did not know them, they were grossly negligent and inattentive to their duties? The testimony convinces me that the latter is the fact, and that their negligence and lack of interest was so profound that not even the disclosures and the warning contained in the letter of the comptroller of October 14, 1892, and which, pursuant to his request, was brought to their attention, aroused them from the stupor which beset them; for the situation was in no wise redeemed, and grew steadily worse without the moving of a hand by the directors to save it. From the time of their election the board of directors seems to have slumbered over the affairs of the bank while its managing officer was plundering it of all that it owned, and much that belonged to others. Once in a while there seems to have been some faint consciousness, but nothing which indicates any activity. But they say, and have called witnesses to prove, that acting in accord with the usage and custom of national banks, and having called into the management a person in whom they had entire confidence, which was justified by his reputation, and committed the affairs of the bank to him, they were not bound to have doubt and distrust of his correct dealing until something occurred which should arouse suspicion. And this is their defense. The learned counsel for the defendants puts the question thus:

"Whether a director in a national bank is individually liable for loss to the bank accruing through another director, viz., its president, when such mismanagement was not known to or participated in by the directors sought to be charged."

Or, in another form:

"Whether an individual director in a national bank is liable in his individual capacity for all losses occasioned by the mis-

management of the bank's affairs by a trusted officer through the neglect of the board of directors to meet and examine into the affairs of the bank."

These questions present in the most favorable light for the defendants what is undoubtedly the substance of the inquiry upon the facts which existed in this case, and which is, in short, this: Whether the duty of the board of directors is discharged by the selection of officers of good reputation for ability and integrity, and then leaving the affairs of the bank without any other supervision or examination than mere inquiry of the officer, and relying upon his statements until some cause for suspicion attracts their attention. Section 9 of the national banking act, being section 5147 of the Revised Statutes, provides that:

"Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association."

And by section 5145 it is declared that the affairs of such association shall be managed by not less than five directors. The oath which the director is required to take, that he will diligently and honestly administer the affairs of such association, indicates the scope of his obligation. The management of the bank is cast upon the board of directors. The duty of managing and administering the affairs of the bank by the board of directors has been differently construed in decisions bearing upon this subject, but it is not necessary for me to anaylze the cases, or to reconcile their apparent differences. Some of them have gone to a length which in my opinion is extremely dangerous to the public safety, and, if generally applied, would make these banking associations, which were designed to supply the people of the country with financial institutions hedged about with security on which their confidence might securely rest, the objects of doubt and distrust. The rule of decision by which my judgment in the present case must be guided is laid down in the case of Briggs v. Spaulding, 141, U. S. 132, 11 Sup. Ct. 924. Much of the discussion in that case was devoted to the consideration of the special circumstances upon which rested the charges made against the several directors. Those circumstances have little or no resemblance to those of the present case, and not much aid is afforded by that part of

the discussion; for, as the court in that case observed, each case must stand upon its own facts. The directors in that case were held to be excusable. One very important and noticeable difference between that case and this is in the fact that the question there was narrowed down to one of fact, as to whether the defendants were fairly liable for not preventing loss by putting the bank into liquidation within 90 days after they became directors, the previous condition of the bank being admitted to have been good, whereas in the present case the defendants' neglect runs through quite a number of years. But the court laid down certain general rules by which the obligation of directors of national banks is to be tested; that is to say, they declare what is the minimum of that obligation. Chief Justice Fuller, delivering the opinion of the court, said:

"We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled, under the law, to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision; nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention."

In my opinion, it does not meet the requirements of this statement of the law that directors may confide the management of the operations of the bank to a trusted officer, and then repose upon their confidence in his right conduct, without making examination themselves, or relying upon his answers to general questions put to him with regard to the status of the affairs of the bank. To begin with, it is to be assumed in every case that the directors have not selected any other than a man of good reputation for capacity and integrity. Any other idea assumes that they have been guilty at the outset of a glaring fault. Further, it is a well-known fact that a large proportion of the disasters which befall banking institutions come from the malfeasance of just such men, and it would be manifest to everybody that only a satisfactory and quieting reply would be made by the official who has any reason for concealment. Again, what are the duties of management that are committed to the cashier, or the officer

standing in his place? They are those which relate to the details of the business, to the conduct of particular transactions. Even in respect of those, his duties are conjoint with those of the board of directors. In large affairs it is his duty to confer with the board. In questions of doubt and difficulty, and where there is time for consultation, it is his duty to seek their advice and direction. It is his duty to look after the details of the office business, and generally to conduct its ordinary operations. It is the right and duty of the board to maintain a supervision of the affairs of the bank; to have a general knowledge of the manner in which its business is conducted, and of the character of that business; and to have at least such a degree of intimacy with its affairs as to know to whom, and upon what security, its large lines of credit are given; and generally to know of, and give direction with regard to, the important and general affairs of the bank, of which the cashier executes the details. They are not expected to watch the routine of every day's business, or observe the particular state of the accounts, unless there is special reason; nor are they to be held responsible for any sudden and unforeseen dereliction of executive officers, or other accidents which there was no reason to apprehend. The duties of the board and of the cashier are correlative. One side are those of an executive nature, which relate mainly to the details. On the other are those of an administrative character, which relate to direction and supervision; and supervision is as necessarily incumbent upon the board as direction, unless the affairs of banks are to be left entirely to the trustworthiness of cashiers. Doubtless there are many matters which stand on middle ground, and where it may be difficult to fix the responsibility, but I think there is no such difficulty here. The idea which seems to prevail in some quarters, that a director is chosen because he is a man of good standing and character, and on that account will give reputation to the bank, and that his only office is to delegate to some other person the management of its affairs, and rest on that until his suspicion is aroused, which generally does not happen until the mischief is done, can not be accepted as sound. It is sometimes suggested, in effect, that, if larger responsibilities are devolved upon directors, few men would be willing to risk their character and

means by taking such an office; but congress had some substantial purpose when, in addition to the provision for executive officers, it further provided for a board of directors to manage the bank and administer its affairs. The stockholders might elect a cashier, and a president as well. The banks themselves are prone to state, and hold out to the public, who compose their boards of directors. The idea is not to be tolerated that they serve as merely gilded ornaments of the institution, to enhance its attractiveness, or that their reputations should be used as a lure to customers. What the public suppose, and have the right to suppose, is that those men have been selected by reason of their high character for integrity, their sound judgment, and their capacity for conducting the affairs of the bank safely and securely. The public act on this presumption, and trust their property with the bank in the confidence that the directors will discharge a substantial duty. How long would any national bank have the confidence of depositors or other creditors if it were given out that these directors whose names so often stand at the head of its business cards and advertisements, and who are always used as makeweights in its solicitations for business, would only select a cashier, and surrender the management to him? It is safe to say such an institution would be shunned and could not endure. It is inconsistent with the purpose and policy of the banking act that its vital interests should be committed to one man, without oversight and control.

Recurring to the present case, it is clear that unless the board of directors is to be absolved upon the theory that they were justified in committing the affairs of the bank to Moore, and relying upon his good conduct, and his answers to the perfunctory questions which were occasionally put to him, until they were brought to the facts by the collapse of the bank upon the first prick of a financial stringency such as came upon the country in the summer of 1893, they must be held liable. It is with sincere commiseration and regret that the court feels compelled to reach this conclusion, in view of the consequence which must follow to these directors. But there is another side to this matter. The court can not ignore the rights and interests of the depositors and others who have trustfully confided their money to the bank, and who now find that it

was run through a shell into the hands of Moore, while the defendants turned their heads away, and failed to give them the protection which a proper discharge of their duties would have afforded. The records of the board of directors make a sorry showing, when put in contrast with the financial history of the bank. The entries are few, at long intervals, and are almost wholly limited to the election of directors and the declaration of dividends. They are feebly supplemented by the oral testimony of the defendants, which tends only to show that individual inquiries were occasionally made by them, of a comparatively superficial character. There was no examination of the books; at least none of any value. If there had been such examination by a fairly intelligent man, such as a director promises he is, the condition of things would have been seen. It is not irreconcilable with what they declared, when the bank failed, with respect to their knowledge of its affairs, and with what I must believe was substantially the truth of the matter. It may be conceded that the members of the board were not responsible for the malfeasance or nonfeasance of their associates, where the fault of the others was not known to them, and they were helpless to prevent the consequences; but in the present case the charge of negligence rests upon the whole board, and there is nothing to show that the defendants took any steps to retrieve the consequences of the joint negligence. If the defendants had been able to show that they themselves had done what they could to induce the board to attend to its duty, a different case would be presented. * * *

Functions of the President.

NATIONAL STATE BANK v. VIGO COUNTY NATIONAL BANK.

141 Ind. 352, 50 Am. St. Rep. 330. 1895.

Action to set aside two mortgages held by Vigo Bank, purporting to have been executed by Sanford Tool Company by its president, "on his own motion and without any authority or permission to him given by said tool company, or its directors or stockholders," and without their consent or subse-

quent ratification. The Vigo Bank demurred; demurrer sustained and exceptions reserved. Sustaining the demurrer is the error assigned.

MONKS, J. * * * The statute under which the tool company was organized provides that the business of the corporation shall be managed by a board of directors, a majority of whom shall constitute a quorum. Section 3854, R. S. 1881; section 5054, R. S. 1894.

Under this statute the directors have full authority to act for the corporation, and represent it in all the matters relating to the corporate business. Brooklyn Gravel Road Co. v. Slaughter, 33 Ind. 185; Board, etc., v. Lafayette, etc., R. Co., 50 Ind. 85.

The president of a corporation, by virtue of his office merely, has very little authority to act for the corporation; his powers depend upon the nature of the company's business and the authority given him by the board of directors. The board of directors may invest him with authority to act as the chief executive officer of the company; this may be done by resolution or by acquiescence in the course of dealing and manner of transacting the business of the corporation. Taylor Corp., §§ 202, 236, 238, and notes; Martin v. Webb, 110 U. S. 7; Northern, etc., R. Co. v. Bastian, 15 Md. 494; Dougherty v. Hunter, 54 Pa. St. 380; Stokes v. New Jersey Pottery Co., 46 N. J. Law 240; Louisville, etc., R. W. Co. v. McVay, 98 Ind. 391; 17 Am. and Eng. Encyc. of Law, pp. 135, 136, 137, and notes; Jones Chat. Mort., § 51.

When a contract is made in the name of a corporation by the president, in the usual course of business, which the directors have the power to authorize him to make, or to ratify after it is made, the presumption is that the contract is binding on the corporation until it is shown that the same was not authorized or ratified. Patterson v. Robinson, 116 N. Y. 193; Eureka Iron and Steel Works v. Bresnahan, 60 Mich. 332; 1 Morawetz Corp., § 538; 1 Beach Corp., § 203; 17 Am. & Eng. Ency. of Law, p. 124.

One dealing with the president of a corporation, in the usual course of business, and within the powers which the president has been accustomed to exercise without objection from the

directors, has the right to assume that the president has been invested with those powers. 1 Morawetz Corp., § 538; 1 Beach Corp., § 203; First Nat'l Bank v. Kimberlands, 16 W. Va. 555; Eureka Iron and Steel Works v. Bresnahan, supra.

Each paragraph of the complaint, however, alleges that said mortgages were executed without any authority whatever, and were never ratified after they were executed, and we are of the opinion that the second, third and fourth paragraphs were sufficient to withstand the demurrer. * * *

Judgment reversed.

CHAPTER XI.

CORPORATE MEMBERSHIP—HEREIN ALSO OF CAPITAL STOCK AND SHARES OF STOCK.

Corporate Capital Stock.

BARRY v. MERCHANTS' EXCHANGE COMPANY.

1 Sandford's Chancery 280 (N. Y.). 1844.

SANDFORD, V. C. * * * It was argued that the amount fixed as the capital stock of the corporation was an absolute restriction upon the amount and value of the property, both real and personal, which they may hold permanently.

Some modifications of this position at once forced themselves upon the attention of the counsel. If the capital were the limit of the property of the corporation they could make no dividends or profits, for those are beyond the capital. Again, in the ever-varying and fluctuating values of all descriptions of property, a corporation that was within its capital last year, may, without a single new purchase or expenditure, be worth this year twenty per cent. beyond its capital by the increased value of the same property.

Hence the learned counsel were driven to rest their point upon a designedly permanent increase of property beyond the capital of the company. Still the rule encountered difficulties.

The object of corporators in all moneyed and business corporations is to make greater profits than they can command by the separate use of the same amount of capital. They put in their money, the capital stock, for the very purpose of having it increase in value, and more rapidly than in private adventures. And we have seen that unless positively enjoined by their charters, there is nothing to require them to divide the increase annually, or in any given time.

It was argued that in this particular case the design was one not referring to profits for ultimate division, but it was a

permanent and solid investment of profits which never could be divided, and which became an essential and integral portion of the real capital of the company. That the exchange was an unit, indivisible, and composed of the capital stock and nearly as much more; the latter being added in anticipation of earnings or profits, and the whole incapable of partition or division.

On this subject of the capital stock of a corporation, the elementary treatises are comparatively barren.

It is the aggregate amount of the funds of the corporators, which are combined together under a charter for the attainment of some common object of public convenience or private utility. This amount is usually fixed in the act of incorporation, although we have seen in the statutes of 1823, one exception to this practice. It is thus limited, in reference to the convenience of the intended corporators, and for the information and security of the public at large. To the corporators, it prescribes the amount and subdivisions of their respective contributions to the common fund; the voice which each shall have in its control and management; and the apportionment of the profits of the enterprise. To the community, it announces the extent of the means contributed and forming the basis of the dealings of the corporate body, and enables every man to judge of its ability to meet its engagements and perform what it undertakes. And when, as in most instances, the statute requires the stock to be paid in before the corporation can transact business, security to those contracting with it is thereby superadded to the information of its resources. These objects, for the public benefit, are sometimes defeated by fraud and deception, but they are such as the legislature have in view in limiting the amount of capital stock, and requiring a specified sum or proportion to be paid in.

One further consideration dictates the amount thus fixed. This is the probable and reasonable extent of the means requisite to the accomplishment of the end proposed, qualified in many cases by the unwillingness of the legislature to create these artificial beings with an undue amount of capital.

As no certain rule can be devised by which to estimate the means necessary to effect all the purposes of a contemplated incorporation, the amount of the capital in each case must be fixed in reference to the considerations which I have just enu-

merated, without any intention or expectation in ordinary cases of limiting to that sum the aggregate property which the corporation, when its capital is paid in and its operations commenced, shall from time to time possess or own. This is peculiarly true of the numerous incorporations which have sprung into being under the magic influence of the enterprise and ingenuity of our citizens, and in which, from their boldness or novelty, it was impracticable for human foresight to calculate the requisite means.

It is true that in one instance the authors of a most excellent treatise on corporations have spoken of capital stock, and the amount of property which they shall hold, as if they were synonymous terms; but they have said on a previous page, that every corporation aggregate has incidentally at common law a right to take, hold and transmit in succession, property real and personal to an unlimited extent or amount. I Angell & Ames on Corp. 87, ch. 5, § 1; 1 Kyd on Corp. 76, 78; 1 Black. Comm. 475; 2 Kent's Comm. 277, 2d ed., and a host of authorities are to the same effect. Angell & Ames also add that "the statutes of mortmain make no mention of personal property, and hence in England the power of corporations aggregate to take such property remains in general unlimited, unless restrained by the charters or acts of parliament establishing them." Treatise on Corp., 90, 92. And see 1 Kyd on Corp. 104.

The capital stock of a corporation is, like that of a copartnership or joint stock company, the amount which the partners or associates put in as their stake in the concern. To this they add upon the credit of the company, from the means and resources of others, to such extent as their own prudence or the confidence of such other persons will permit. Such additions create a debt; they do not form capital. And if successful in their career, the surplus over and above their capital and debts becomes profits, and is either divided among the partners and associates, or used still farther to extend their operations.

The proposition that a corporation is limited, even in its permanent ownership of property, to the amount fixed as its capital, is entirely new, and has not the sanction of authority or reason. The custom of retaining the profits, which I have before mentioned, has been long continued, and has worked in many of our corporations, and especially in banking insti-

tutions, an increase of their solid property and estate, as permanent as any that has been inferred in this case. Not that such increase has in those instances been so invested and mingled with the fruits of the original capital as to become indivisible therefrom; but the increase has in many of the instances been as fixed and permanent as the capital itself, and with no purpose or probability of its being returned to the stockholders until the concern should be wound up voluntarily, or by the expiration of the charters. Some further illustration of this question will occur in connection with the discussion of the power of borrowing after the payment of the capital.

Second. The second theory of the counsel for the complainant was, that the power of borrowing money was limited to the extent of the capital of the company; and when that capital was fully paid, the power ceased, except for mere temporary objects, and for short periods.

They therefore had no right to contract a permanent debt like these mortgages. That if they did not expect to pay the mortgages, it is still worse, because by the means used they created, or attempted to create, a public stock or funded debt.

It was urged that on the latter hypothesis they were exceeding the charter, because the direct consequence is, that they build at the expense of two millions, and out of the rents pay an interest to the bondholders, and a dividend to the stockholders; and the one to continue as long as the other, being to all intents a capital of two millions.

This argument is specious, for if the building be worth the two millions, which it is assumed to have cost, and the company owes one million, their clear property is but one million after all. Then as to the funded debt or stock created and secured by these mortgages. The fifth section of the act of incorporation was referred to as prohibiting this mode of effecting a loan. That section declares that the act shall not be construed to authorize the dealing or trading in, or the purchase or sale of any stock or funded debt created, or to be created, under any law of the United States, or of any particular state.

If the resemblance between these bonds and such stock or funded debt were complete in all things, this section would

have no application to the borrowing of money upon their issue. But, in truth, the resemblance is very faint. The bonds were printed or engraved, and had coupons attached for convenience in the collection of interest. There the likeness ceased. These bonds were sealed obligations of the company, bonds, in the technical sense of the word, and secured not by the public faith, or the mere corporate liability, but by mortgages on real estate.

But it was contended that the unrestricted power of borrowing, which the company claims for effecting the purposes of its charter, virtually confers upon the corporation unlimited power. That the purposes of the charter would, in this instance at least, be no restraint, because they could embrace accommodations for every description of commercial business, and the extent of their credit would be equally ineffectual, for there would be no limit to that, except in the prudence of the lender, and finally, that no such extravagant authority was granted to this corporation, expressly or by implication, and it is contrary to the spirit and policy of our laws and institutions.

This whole argument is, in my judgment, unsound. The danger of inordinate accumulation of property and consequent overshadowing power is wholly fallacious. The whole extent of the corporate credit is, in truth, measured and controlled by its capital. Every addition to its means beyond its paid-up capital (leaving profits out of view) must be by gift or contract, and if by contract, a debt ensues. If a corporation with a million of capital succeeds in running into debt two millions it has no more solid property, and is intrinsically worth no more than before, unless the property obtained on credit is worth more than it cost, and then the increase of property is only such excess of value. And if worth less than cost, then the company has by the operation sunk a part of its capital.

All experience shows that the financial management of corporations is, in general, less judicious and safe than that of individual. Hence losses are likely to ensue from expansions upon credit; and the farther such credit is pushed by any corporation, the greater the danger that such losses will impair and finally consume its capital. The lenders of money are usually sagacious enough to protect their interests when dealing with corporations as well as with individuals; and few

would lend money to a company which already owed debts greatly exceeding its whole capital stock, however flattering in appearance the investment might be. The laws of trade have placed an impassable barrier to the power of corporate borrowing, in the tendency of such institutions to make an improvident use of exuberant means, and in the caution and prudence of capitalists. It is utterly impossible for a corporation with a known limited capital to accumulate by means of its credit gigantic property and power which the imagination of the counsel portrayed. * * *

In this case, then, I am satisfied that the Merchants' Exchange Company were authorized by law to borrow money for the completion of their building, to the extent adopted by them, and to secure its repayment by their corporate obligations, and by mortgages on their real estate.

I do not find that any limitation contained in their charter has been thereby exceeded, nor that any condition annexed to the grant of their franchise has been broken, nor that they have failed to perform the duties enjoined upon them by the law of their creation. * * *

Bill dismissed.

Capital Stock.

COMMERCIAL FIRE INSURANCE CO. v. BOARD OF REVENUE.

99 Ala. 1. 1892.

STONE, C. J. * * * What is capital stock of corporations, and why are they required to have a capital stock paid in? * * *

Stocks—shares in corporations—have come to be, in a large degree, subjects of commercial dealing and speculation. The newspapers contain tables of the ruling prices of stocks, as their market value fluctuates. These notices refer to the shares of stock in organized corporations. Their sale neither increases nor diminishes the capital stock in the corporation; it neither adds to, nor takes from the corporation on dollar of its stock. It simply changes its ownership *pro tanto*. The capital remains in the corporation intact, and the security it furnishes, and is

intended to furnish, the creditors of the corporation remains unimpaired.

When we speak of capital stock of a corporation, we are understood to refer to the sum subscribed in its organization. When we speak of stock, we mean the certificates issued by the corporation to the shareholders, which certificates, like titles to property, furnish the evidence of ownership of the shares of stock. Capital stock is the aggregate of money or other valuable thing contributed, or paid into the common treasury as a condition of the exercise of corporate functions, and a security for their faithful and prudent exercise. It is the property of the corporation, charged with a trust, it is true; but nevertheless, in its possession and under its control. The stock, stocks or shares of stock do not belong to the corporation. They belong to the shareholders and are exclusively under the individual control of the several owners. The stocks which the statute anthorizes insurance companies to invest their money in can not mean capital stock owned and to be held by the corporation. This, we have seen, is a trust fund. It means the stock owned by the stockholders, usually evidenced by stock certificates. Stock, as a subject of commercial dealing, is what the legislature meant in the statute we are interpreting. The very connection in which the word is used in the statute confirms this interpretation. * * *

We have shown by the highest legal authority that the capital stock of a corporation is a trust fund for the security and benefit of the creditors of the corporation, and that the managing board fills the relation of trustee for its preservation and administration. Corporations acting within the scope of corporate powers, fix no liability on their officers or on any one else. They charge only the corporation. Hence the purpose and policy of requiring a capital stock as security and indemnity of persons who become its creditors. The law-making power confers on them privileges—a franchise, a right to make contracts in its artificial name without fastening a liability on any natural person—and it exacts from them as a condition on which it grants this franchise, this privilege and power, that they place a capital stock in safe pledge for the security of their creditors. And this capital stock is a permanent investment, with no power in the shareholder to with-

draw it until the corporation is wound up and all its debts paid, and no power in the managing board to permit it to be withdrawn at the expense of creditors. It is a trust fund in the corporation's treasury, to be used only in its interest, and whatever of profit or emolument it may yield belongs of right to the corporation, its creditors and shareholders. It must be kept within the corporation and under its control to meet the purpose for which it was required to be raised and paid in. It is not materially unlike any other pledge that is placed as a guaranty of faithful performance of debt or duty. It is a fixed pledge until the debt is paid, or the duty performed. * * *

Transfer of Stock in Abuse of Authority.

McNEIL v. THE TENTH NATIONAL BANK.

46 N. Y. 325, 7 Am. Rep. 341. 1871.

Appeal from a judgment of the General Term, affirming a judgment, in favor of the plaintiff.

The action was brought, to compel the surrender to the plaintiff of 134 shares of the capital stock of the First National Bank of St. Johnsville, which had been acquired by the appellant in the following manner:

In November, 1866, the plaintiff then being the owner of the shares in question, had an account with Goodyear Brothers & Durant, of the city of New York, stock brokers, relating to other stocks, which they had purchased and were carrying for him. For the purpose of securing any balance which might become due them on that account, the plaintiff delivered to and left with them, the certificate of the 134 shares in dispute, with a blank assignment, and power of attorney to transfer indorsed thereon, signed by the plaintiff, in the following words:

For value received, the undersigned hereby assigns and transfers unto * * * shares of the capital stock of the First National Bank of St. Johnsville, and do hereby constitute and appoint * * * true and lawful attorney, irrevocable for * * * and in * * * name and behalf, to make

and execute all necessary acts of assignment and transfer required by the regulations and by-laws of said bank.

In witness whereof, I have hereunto set my hand and seal this —— day of ——.

(Signed.) B. McNEIL.

Sealed and sworn in presence of ——.

On the 18th of June, 1868, at the city of New York, the appellant at the request of Goodyear Brothers & Durant, paid the sum of $45,135 to Fred. Butterfield, Jacobs & Co., receiving from them certain securities, including the certificate and power for the 134 shares in question, which had been previously pledged by Goodyear Brothers & Durant to Fred. Butterfield, Jacobs & Co.

Goodyear Brothers & Co. were at that time insolvent, and indebted to the appellant. In pledging the plaintiff's shares, they had acted without actual authority from him, and without his knowledge. He was indebted to them, on the account for which the shares were pledged to them, in the sum of $3,000 with interest from December 1, 1866; but the account had not been rendered, or any demand made.

The appellant at the time of receiving the shares, had no knowledge of the plaintiff's interest therein.

The cashier of the appellant, within a few days after receiving the certificate, assignment and power, filled in the blank in the assignment and power with "I. H. Stout, cashier, Tenth National Bank, New York, one hundred and thirty-four," and dated the same the 19th day of June, 1868, and sent the scrip to the First National Bank of St. Johnsville, for the purpose of having the shares transferred on the books accordingly; but such transfer was prevented by an order of injunction in this action.

The plaintiff demanded of the appellant a surrender of the scrip, on payment of the balance due by him to Goodyear Brothers & Durant; which demand was refused.

The value of the shares was $17,420. The balance of the advance made by the appellant thereon ($45,135, less the proceeds of the other securities received therewith, $29,915.19), was $15,219.81, besides interest.

When the certificate and power came to the possession of the appellant, they bore the proper revenue stamp, duly cancelled

with the stamp of the Goodyear Brothers & Durant, and the name of Ch. Goodyear as subscribing witness to the power. The referee found, that when the plaintiff delivered them, they were not stamped or witnessed, and that the plaintiff had never authorized those acts.

The referee found in favor of the plaintiff, and in conformity with his report, a judgment was entered, requiring the surrender of the scrip to the plaintiff, on payment by him of the $3,000 and in interest due by him to Goodyear Brothers & Durant.

This judgment was affirmed at General Term.

RAPALLO, J.—The pledge of the plaintiff's shares by his brokers, for a larger sum than the amount of their lien thereon, was a clear violation of their duty, and excess of their actual power. And if the effect of the transaction was merely to transfer to the appellant, through Fred. Butterfield, Jacobs & Co., the title or interest of Goodyear Brothers & Durant in the shares, the judgment appealed from was right.

It must be conceded, that as a general rule, applicable to property other than negotiable securities, the vendor or pledgor can convey no greater right or title than he has. But this is a truism, predicable of a simple transfer from one party to another where no other element intervenes. It does not interfere with the well-established principle, that where the true owner holds out another, or allows him to appear, as the owner of, or as having full power of disposition over the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected. Their rights in such cases do not depend upon the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which, through negligence or mistaken confidence he caused or allowed to appear to be vested in the party making the conveyance. (Pickering v. Busk, 15 East, 38; Gregg v. Wells, 10 Adol. & El., 90; Saltus v. Everett, 20 Wend., 268, 284; Mowrey v. Walsh, 8 Cow., 238; Root v. French, 13 Wend., 570.)

The true point of inquiry in this case is, whether the plaintiff did confer upon his brokers such an apparent title to, or

power of disposition over the shares in question, as will thus estop him from asserting his own title, as against parties who took bona fide through the brokers.

Simply intrusting the possession of a chattel to another as depositary, pledgee or other bailee, or even under a conditional executory contract of sale, is clearly insufficient to preclude the real owner from reclaiming his property, in case of an unauthorized disposition of it by the person so intrusted. (Ballard v. Burgett, 40 N. Y. R. 314.) "The mere possession of chattels, by whatever means acquired, if there be no other evidence of property or authority to sell from the true owner, will not enable the possessor to give a good title." Per Denio, J. in Covill v. Hill (4 Den., 323).

But if the owner intrusts to another, not merely the possession of the property, but also written evidence, over his own signature, of title thereto, and of an unconditional power of disposition over it, the case is vastly different. There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the depositary, or under contingencies to arise. If the conditions upon which this apparent right of control is to be exercised, are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case cannot be distinguished in principle, from that of an agent who receives secret instructions qualifying or restricting an apparently absolute power.

In the present case, the plaintiff delivered to and left with his brokers, the certificate of the shares, having indorsed thereon the form of an assignment, expressed to be made "for value received," and an irrevocable power to make all necessary transfers. The name of the transferee and attorney, and the date, were left blank. This document was signed by the plaintiff, and its effect must be now considered.

It is said in some English cases, that blank assignments of shares in corporations are irregular and invalid; but that opinion is expressed in cases where the shares could only be transferred by deed under seal, duly attested, and is placed upon the ground that a deed can not be executed in blank.

Without referring to the American doctrine on that subject, it is sufficient to say that no such formality was requi-

site in this case. It was only necessary to a valid transfer as between the parties, that the assignment and power should be in writing. The common practice of passing the title to stock by delivery of the certificate with blank assignments and power, has been repeatedly shown and sanctioned in cases which have come before our courts. Such was established to be the common practice in the city of New York, in the case of the New York and New Haven Railroad Company v. Schuyler (34 N. Y. 41), and the rights of parties claiming under such instruments were fully recognized in that case. And in the case of Kortright v. The Commercial Bank of Buffalo (20 Wend., 91, and 22 Wend., 348), the same usage was established as existing in New York and other states, and it was expressly held that even in the absence of such usage, a blank transfer on the back of the certificate, to which the holder has affixed his name, is a good assignment; and that a party to whom it is delivered is authorized to fill it up, by writing a transfer and power of attorney over the signature.

It has also been settled, by repeated adjudications, that, as between the parties, the delivery of the certificate, with assignment and power indorsed, passes the entire title, legal and equitable, in the shares, notwithstanding that, by the terms of the charter or by-laws of the corporation, the stock is declared to be transferable only on its books; that such provisions are intended solely for the protection of the corporation, and can be waived or asserted at its pleasure, and that no effect is given to them except for the protection of the corporation; that they do not incapacitate the shareholder from parting with his interest, and that his assignment, not on the books, passes the entire legal title to the stock, subject only to such liens or claims as the corporation may have upon it, and excepting the right of voting at elections, etc. (Angell and Ames on Corporations, 8th ed., § 354; Bank of Utica v. Smalley, 2 Cow., 770; Gilbert v. Manchester Co., 11 Wend., 627; Kortright v. Com. Bank of Buffalo, 22 Wend., 362; N. Y. and N. H. R. R. Co. v. Schuyler, 34 N. Y., 80.)

In the case of Kortright v. Com. Bank, Chancellor Walworth, in a dissenting opinion, strenuously maintained, in conformity with his previous decision in Stebbins v. Phœnix Ins. Co. (3 Paige, 356), that by a transfer not on the books, the

transferee acquired only an equitable right to or lien on the shares; and that, having but an equitable right or lien, he took subject to all prior equities which existed in favor of any other person from whom such assignment was obtained. (22 Wend., 352, 353, 355.) But his view was overruled by the majority of the court. The action was at law in assumpsit, brought by the holder of the certificate and power, for a refusal to permit him to make a transfer on the books, and the question of his legal title was necessarily involved in the case. The judgment therein must therefore be regarded as a direct adjudication that, as between the parties, the legal title to the shares will pass by delivery of the certificate and power. (See 20 Wend., 362.)

This was reasserted in this court in the New Haven Railroad Case (34 N. Y., 80), notwithstanding what was said in the Mechanics' Bank Case (13 id., 625).

By omitting to register his transfer, the holder of the certificate and power fails to obtain the right to vote, and may lose his stock by a fraudulent transfer on the books of the company, by the registered holder, to a bona fide purchaser (34 N. Y., 80); but in this respect he is in a condition analogous to that of the holder of an unrecorded deed of land, and possesses a no less perfect title as against the assignor and others. And he would have an action against the corporation, for allowing such a transfer in violation of his rights. (Id.) He also takes the risk of the collection of dividends by his assignor, or of any lien the corporation may have on the shares. But in other respects his title is complete.

The holder of such a certificate and power, possesses all the external indicia of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited, concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they take subject to all equities, latent or otherwise, of third parties; but, apparently, the legal title, and the means of transferring such title in the most effectual manner.

Such, then, being the nature and effect of the documents with which the plaintiff intrusted his brokers, what position does he occupy toward persons who, in reliance upon those documents, have in good faith advanced money to the brokers

or their assigns on a pledge of the shares? When he asserts his title, and claims, as against them, that he could not be deprived of his property without his consent, can not he be truly answered that, by leaving the certificate in the hands of his brokers, accompanied by an instrument bearing his own signature, which purported to be executed for a consideration, and to convey the title away from him, and to empower the bearer of it irrevocably to dispose of the stock, he in fact "substituted his trust in the honesty of his brokers, for the control which the law gave him over his own property," and that the consequences of a betrayal of that trust, should fall upon him who reposed it, rather than upon innocent strangers from whom the brokers were thereby enabled to obtain their money?

These principles, in substance, were applied in the case of Kortright v. The Commercial Bank. But it is sought to distinguish that case from this; and it is argued, that there the certificate was intrusted to an agent, with authority from his principal to borrow money upon it for the benefit of his principal, and that he simply exceeded his authority by borrowing more than he was authorized to borrow, and absconding with the excess. (The judge proceeded to consider that decision.)

The principles of agency are, however, applicable to this case. In disposing of a pledge, the pledgee acts under a power from the pledgor. The distinction between a lien and a pledge is said to be, that a mere lien can not be enforced by sale by the act of the party, but that a pledge is a lien with a power of sale superadded. (Story on Bailments, 7th ed., § 311, note 2; Wasson v. Smith, 2 B. & Ald., 439.) The pledgee in selling, is bound to protect the interest of the pledgor, and as to the surplus, represents the pledgor exclusively. Now, for what purpose was the apparent ownership and power of disposition of this stock vested in the brokers? Surely for the purpose of enabling them, effectually and summarily, to execute this power under certain conditions. If the power was absolute on its face, or if the whole legal title was by the instrument apparently vested in the pledgee, and the condition was secret, wherein does the case differ in principle from one of ordinary agency?

I am at a loss to conceive on what principle it can be claimed

that an apparent naked authority is more effectual to bind the party giving it than an apparent ownership as well as authority. (The learned judge reviewed the authorities.) * * *

My conclusion is, that the Tenth National Bank must, on the facts found, be deemed to have advanced bona fide on the credit of the shares, and of the assignment and power executed by the plaintiff, and is entitled to hold the stock for the full amount so advanced, and remaining unpaid after exhausting the other securities received for the same advance.

The judgment of the General Term, should be modified, so as to allow the plaintiff to redeem, on payment of the balance due to the Tenth National Bank, on its advance of June 19th, 1868, and the costs of the action.

All concur, except ALLEN and FOLGER, JJ., not voting.

Judgment modified.

CHAPTER XII.

SAME TOPIC—THE RIGHTS OF STOCKHOLDERS.

Right of Stockholder to Sue On His Own Behalf.

DOUSMAN v. THE WISCONSIN AND LAKE SUPERIOR MINING AND SMELTING COMPANY.

40 Wis. 418. 1874.

Plaintiff alleged he was the owner of seven shares in the company, all of which were fully paid; that there were 131 shares of $500 each, none of which (except plaintiff's shares and one other) were more than half paid up. Under authority it was determined to increase the stock to 1,000 shares, of which 250 were to be used in performing a contract with another corporation, 95 shares reserved to the company, and the other 655 shares issued to the shareholders,—five shares fully paid for each share of the old stock. Plaintiff alleged that the company refused to allow him any greater interest for his fully-paid shares than was allowed to a like number of half-paid shares; he asked that he be allowed new shares, in proportion to the amount paid, or that half of those issued to holders of half-paid stock be canceled. The facts were found as alleged, and further distribution was enjoined, unless the issue of new shares were made in proportion demanded by plaintiff.

RYAN, C. J. 1. The injury which the respondent, as a shareholder of the appellant, sets up in his complaint, is one peculiar and personal to himself, not common to other shareholders, alleged to have been committed by the board of directors, as the governing body of the corporation; that is, by the corporation itself. Clearly his remedy is against the corporation. Probably he might have maintained an action at law against it. Gray v. Portland Bank, 3 Mass. 364. But the effect of such an action would be to convert part of his interest as a shareholder into a judgment for damages; in other

words, to sell a portion of his stock to the corporation. That he is not obliged to do. He has a right to maintain his proportionate interest in the corporation, certainly as long as there is sufficient stock remaining undisposed of by the corporation. Trading corporations of the character of the appellant have been likened to partnerships, and the remedies of stockholders to those of partners, by very high authority. Gray v. Portland Bank, *supra;* Robinson v. Smith, 3 Paige 222; Adley v. Whitstable Co., 17 Vesey 315. And equity has always afforded a remedy to a stockholder, in such a case as this, by injunction, account, or other appropriate decree. Adley v. Whitstable Co., *supra.* This principle has been repeatedly recognized in this court, as in Putnam v. Sweet, 2 Pin. 302; Nazro v. Ins. Co., 14 Wis. 319.

Such a case is clearly distinguishable from suits by stockholders in the right of the corporation, founded on wrongs against the corporation. In that class of cases, as the authorities cited by the appellant show, the right of suit is primarily in the corporation itself; and stockholders take the right, in lieu of the corporation, only upon refusal of the governing body of the corporation to sue.

Here the wrong complained of is by the corporation, not against it. The right is against it, not against individual directors. The judgment, to be effectual, must be against the corporation itself; not against the directors personally, who may be changed from time to time. And even where a suit would lie by a corporation against its governing body for wrongs done against it by the governing body, it is sufficiently manifest that a demand upon the governing body to bring the suit would be nugatory.

2. If there are other shareholders in like condition as the respondent, their right and his are several; they may bring their separate suits, or they may submit to the wrong at their several pleasure. The respondent has no right to represent them. The case is entirely distinguishable from a wrong done by the governing body common to all the stockholders. * * *

Affirmed.

CHAPTER XIII.

CORPORATE CREDITORS.

Rights of Creditors Against the Corporation.

POND ET AL. v. FRAMINGHAM & LOWELL R. R. CO.

130 Mass. 194. 1881.

MORTON, J. This is a bill in equity, the substantial allegations of which are, that the plaintiffs are creditors of the defendant corporation; that the corporation is insolvent; that all its property is mortgaged to trustees for the benefit of one class of creditors; that it owes large amounts to other creditors, one of whom has attached all its property; that it is about to execute a lease to said attaching creditor for the term of nine hundred and ninety-nine years, at a rental which will not pay the interest upon its indebtedness, and that the execution of said lease would be injurious to the interest of its creditors and stockholders. The prayer is for an injunction to restrain the defendant from further prosecuting its business, and for the appointment of receivers.

There is no statute giving this court equity jurisdiction in such a case as this, and the bill does not state a case within the general equity powers of a court of chancery. As is stated in Treadwell v. Salisbury Manuf. Co., 7 Gray 393, "It is too well settled to admit of question, that a court of chancery has no peculiar jurisdiction over corporations, to restrain them in the exercise of their powers, or control their action, or prevent them from violating their charter, in cases where there is no fraud or breach of trust alleged as the foundation of the claim for equitable relief."

The plaintiffs cannot maintain this bill, unless upon the ground that any creditor can maintain a bill in equity against an individual debtor upon like allegations. But there is no allegation of fraud or breach of trust, or any other ground of jurisdiction, which brings the case within the general

equity powers of a court of chancery. The bill is an attempt by a creditor to restrain his debtor from making what is alleged to be an improvident contract. The rights of the parties are governed by the rules of the common law. The plaintiffs as creditors might, by an attachment, have obtained security which would take precedence of the contemplated lease; but if they could not, the court has no power to restrain the debtor from making a disposition of his property which is permitted by the common law, unless fraud or breach of trust is alleged and shown.

The allegation that the defendant corporation is insolvent does not aid the plaintiffs. In the absence of any statute giving the power, this court has no authority to act as a court of insolvency for the liquidation of the affairs of an insolvent railroad corporation.

Decree dismissing the bill affirmed.

Trust Fund Doctrine.

COLE v. THE MILLERTON IRON COMPANY.

133 N. Y. Rep. 164, 28 Am. St. Rep. 615. 1892.

(This action was brought by plaintiff, a judgment creditor of the National Mining Company of Pawling, to set aside a conveyance made by it of all its property to defendant, the Millerton Iron Company, and also to release said property from the lien of a mortgage executed by that company to defendant, the Mercantile Trust Company, and for appointment of a receiver, etc.)

FINCH, J. The plaintiff is a creditor of the National Mining Company, a corporation formed and existing under the laws of this state. He commenced an action to recover damages done to his property by the wrongful act of the corporation, serving the summons in October, 1887, and recovering judgment in July of the next year. During the pendency of the action all the property and assets of the debtor corporation were transferred to the Millerton Iron Company, also a domestic corporation, upon a nominal consideration, except an assumption by the vendee of the debts of the vendor, and

thereupon the former executed a mortgage to the Mercantile Trust Company covering all its property, including that acquired from the National Mining Company. When the plaintiff obtained his judgment nothing remained upon which it was a lien and his execution was returned unsatisfied. He then began this action, in which he assailed the transfers made with a view of subjecting the property of the debtor corporation to the satisfaction of his debt. Upon the trial his complaint was dismissed, but the general term reversed the judgment and ordered a new trial. From that order the trust company alone appeals and has given the usual stipulation for judgment absolute.

The trial court has refused to find that the National Company was insolvent at the date of its transfer, but did find that such transfer suspended and terminated the regular business of the grantor, and was made and accepted with that purpose and intention. The practical effect was to dissolve the grantor corporation and subject its charter to forfeiture at the hands of the state, for it voluntarily stripped itself of all its property and assets and became incapable, and intended to be and remain incapable, of performing its corporate duties. Such a transfer, which involves the destruction of the corporation and an abandonment of the purposes of its organization, is illegal as against creditors, whose rights are thereby sacrificed and their remedies destroyed. The transfer was illegal, also, because made in contemplation of insolvency. Those who accomplished it knew that its necessary and inevitable effect would be to make the corporation unable to pay its debts, and must be held to have intended that consequence of their acts. I do not agree to that reading of the statute which limits its prohibition to cases in which payment of some note or obligation has been previously refused. An interpretation so narrow would seriously maim and distort the obvious purpose of the statute and make a transfer, in contemplation of insolvency, good the day before a note matured and bad the day after. As against the creditor the transfer to the Millerton Company was illegal and in fraud of its rights. The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien, both as against the stockholders and all transferees, except those

purchasing in good faith and for value. (Bartlett v. Drew, 57 N. Y. 587; Brum v. Ins. Co., 16 Fed. Rep. 140; Morawetz on Corporations, 791.) The Millerton Company was not such a purchaser. It parted with nothing. It knew and participated in the illegal purpose to destroy the National Company, to make it utterly insolvent, and to deprive its creditors of the trust fund upon which they had a right to rely, and so they were at liberty to set aside the transfer so far as it barred their remedy and to enforce their equitable lien upon the property in the hands of the transferee.

It is not a sufficient answer to say that the transfer was rather formal than real, because, before its occurrence, the Millerton Company, having the same stockholders and officers, managed and conducted the business of the National Company before the transfer as well as after, and that what occurred was a practical consolidation. Companies may consolidate, but under the permission and safeguards of the statute, all of which were disregarded, and what is called the formal transaction cuts off and destroys the right of the creditor, and is being used for that exact purpose.

Neither is it an answer to say that the creditor is not harmed by a change of the party liable to pay, unless there be some disproportion in the assets. He cannot be forced to change his debtor against his will, and it appears in the proof that the transfer to the Millerton Company was followed by a mortgage sweeping in it to its lien and peril the very property transferred.

We are satisfied, therefore, that the plaintiff was entitled to judgment of sequestration and for a receiver, and so the order of the general term was right. The judgment obtained by Chapman is not a bar to the remedy. It is not relied upon for that purpose, and the appointment of a receiver was without notice to the attorney-general, as the law required. (Laws of 1883, ch. 378.) In the present case the plaintiff must give such notice when he applies for the appointment.

The rights of the mortgagee, who is the present appellant, need not now be accurately determined. Whether that mortgage was valid at all for wants of proper consents, or whether any of the bondholders have acquired equities superior to those of the plaintiff, may or may not become questions in the

future. Enough appears to show that some of them do not stand in the attitude of bona fide creditors, and that the remedies of all may be confined to the property of the Millerton Company not derived from the National, until at least the former is exhausted. Those questions, however, may be left to the developments consequent upon further proceedings.

The order of the general term should be affirmed and judgment absolute for the plaintiff be rendered upon the stipulation, with costs. All concur.

Order affirmed and judgment accordingly.

CHAPTER XIV.

DISSOLUTION OF CORPORATIONS.

Methods of Dissolution of Corporations.

THE BOSTON GLASS MANUFACTORY v. LANGDON.

24 Pick. 49 (Mass.), 35 Am. Dec. 292. 1834.

Assumpsit by Glass company upon a note given by defendant to plaintiff. Plea in abatement that there was at time of suit no such corporation—the facts showing an incorporation and organization in 1811, an assignment of all the corporate property in 1817 to trustees to pay creditors, and an omission to hold annual meetings, choose directors or transact business since that time. The jury were instructed that the corporate life continued, and they found for the plaintiff. The instructions and verdict upon them are assigned as errors.

MORTON, J. * * * The legal establishment and due organization of the corporation were admitted; but it was contended that the facts disclosed showed a dissolution of it.

The elementary treatises on corporations describe four methods in which they may be dissolved. It is said that private corporations may lose their legal existence by the act of the legislature; by the death of all the members; by a forfeiture of their franchises; and by a surrender of their charters. 2 Kyd Corp. 447; 1 Bl. Comm. 485; 2 Kent's Comm. (1st ed.) 245; Angell and Ames Corp., 501; Oakes v. Hill, 14 Pick. 442. No other mode of dissolution is anywhere mentioned or alluded to.

1. In England, where the parliament is said to be omnipotent, and where in fact there is no constitutional restraint upon their action, but their own discretion and sense of right, corporations are supposed to hold their franchises at the will of the legislature. But if they possess the power to annul charters, it certainly has been rarely exercised by them. In this country, where the legislative power is carefully defined

by explicit fundamental laws, by which it must be governed and beyond which it cannot go, it has become a question of some difficulty to determine the precise extent of their authority in relation to the revocation of charters granted by them. But as it is not pretended that there has been any legislative repeal of the plaintiff's charter, it will not be useful further to discuss this branch of the subject.

2. As all the original stockholders are not deceased, the corporation cannot be dissolved for the want of members to sustain and exercise the corporate powers. Besides, this mode of dissolution cannot apply to pecuniary or business corporations. The shares, being property, pass by assignment, bequest or descent, and must ever remain the property of some persons, who of necessity must be members of the corporation as long as it may exist.

3. Although a corporation may forfeit its charter by an abuse or misuser of its powers and franchises, yet this can only take effect upon a judgment of a competent tribunal. 2 Kent's Comm. (1st ed.) 249; Corporation of Colchester v. Seaber, 3 Burr. 1866; Smith's Case, 4 Mod. 53. Whatever neglect of duty or abuse of power the corporation may have been guilty of, it is perfectly clear that they have not lost their charter by forfeiture. Until a judicial decree to this effect be passed, they will continue their corporate existence. The King v. Amery, 2 T. R. 515.

4. Charters are in many respects compacts between the government and the corporators. And as the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the compact without the consent of the former. It is equally obligatory on both parties. The surrender of a charter can only be made by some formal solemn act of the corporation; and will be of no avail until accepted by the government. There must be the same agreement of the parties to dissolve that there was to form the compact. It is the acceptance which gives efficacy to the surrender. The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act would be a dangerous power, and one which cannot be supposed to exist.

But there is nothing in this case which shows an intention

of the corporators to surrender or forfeit their charter, nor anything which can be construed into a surrender or forfeiture.

The possession of property is not essential to the existence of a corporation. 2 Kent's Comm. (1st ed.) 249. Its insolvency cannot, therefore, extinguish its legal existence. Nor can the assignment of all its property to pay its debts, or for any other purpose, have that effect. The instrument of assignment was not so intended, and cannot be so construed. All its provisions look to the continuance of the corporation. It contains covenants that the assignees may use the corporate name for the collection of the debts and the disposition of the property assigned; that the corporation will not hinder or obstruct them in the performance of these functions; that it will make any further conveyances and assurances which may become necessary, and will do and perform any other and further acts which may be required to enable the assignees fully to execute their trust. The instrument which covenants for future acts cannot be construed to take away all power of action.

The omission to choose directors clearly does not show a dissolution of the corporation. Although the proper officers may be necessary to enable the body to act, yet they are not essential to its vitality. Even the want of officers and the want of power to elect them, would not be fatal to its existence. It has a potentiality which might, by proper authority, be called into action without affecting the identity of the corporate body. Colchester v. Seaber, 3 Burr. 1870.

But here in fact was no lack of officers. Although no directors had been chosen for several years, yet by the by-laws of the corporation the directors, though chosen for one year, were to continue in office till others were chosen in their stead. * * *

Affirmed.

Effect of Dissolution.

STATE BANK v. THE STATE.

1 Blackf. 267 (Ind.), 12 Am. Dec. 234. 1823.

Quo warranto against the bank for numerous violations of its charter. The defendant pleaded not guilty to all the charges. On the trial in the lower court the jury found them guilty of nine of the charges. A motion in arrest of judgment was made and overruled, and judgment given that the privileges, liberties and franchises be seized into the custody of the state, together with all the goods, chattels, rights, credits and effects of every kind. Various errors were assigned, two of which were: 1, that the charges did not justify a forfeiture, and 2, the judgment of seizure of the franchises and property violated the constitution of the state, providing that no man's property should be taken for a public use without the consent of his representatives, etc.

HOLMAN, J. * * * That a corporation may forfeit its charter for misusing or abusing its franchises is a doctrine that cannot now be disputed. See 1 Bl. Comm., 485; 2 Kyd Cor., 474, and the cases there cited. For there is an implied condition annexed to each particular grant, which, if violated, forfeits the whole franchise. 2 Bac., 31. Inasmuch as it is the duty of corporations to act up to the end or design for which they were created (1 Bl. Comm., 480) so when they pursue such measures as wholly frustrate this design the reason of their existence ceases, and it is but just that their existence should also be terminated. Whether every slight deviation from the intention of the charter should occasion a forfeiture is not the question, but when the grand, leading conditions and restrictions in the charter have been violated there can be no question but the franchises are thereby forfeited. Several of the charges found by the jury against this corporation are of this nature, and show that they have evidently abused their most important privileges to the manifest injury of others and of the community in general. * * *

But if it be contended that such a private property exists in the individual shareholders as will be destroyed if the fran-

chises of the corporation be seized, and, inasmuch as the private property is guaranteed by the constitution, that the constitution must also of necessity guaranty the continued existence of those franchises or otherwise this property will be annihilated, we shall find that this doctrine is not warranted by the constitution. The privilege of holding stock in this bank is inseparably connected with its existence as a corporation, and inasmuch as we have seen that the existence of the corporation depends on the implied condition that it will not violate its charter, so this privilege of holding stock in this bank must depend for its continuance on the same implied condition. The president and directors of the corporation become the agents of the stockholder, and if they violate the conditions on which he enjoys this privilege, his privilege is immediately subjected to forfeiture by this act of his agents. Nor will the regard which the constitution has for private property secure such property from annihilation by a dissolution of the corporation. So that we see nothing in the constitution to prevent the seizure of those franchises, let the effect upon private property be what it may. And there can be no doubt but that this judgment, so far as it authorizes a seizure of the franchises into the hands and custody of the state, is warranted by law. When it appears that the liberty has been once granted, and is forfeited by misuser or nonuser, the judgment shall be that it be seized into the king's hands. Year Book 15 Ed. 4, cited in 2 Kyd Corp., 407. And such appears to be the law at present. * * *

There are but two grounds on which it can be contended that the corporate effects fall into the hands of the state: 1. As a forfeiture for abusing the franchises; or 2. For the want of an owner by the dissolution of the corporation. When we examine the first of these grounds we find nothing in the books to support an idea that the abuse of corporate franchises occasions forfeiture of lands or goods, rights or credits, or, in fact, occasions any other forfeiture but the franchises themselves. The consequence of a breach of the implied condition on which their liberties were granted was not that they should forfeit their property or possessions if they abused their franchises, but only that they should forfeit their franchises. That which comes out of the hands of the king is the

proper subject of forfeiture; the king, by the seizure, resuming what originally flowed from his bounty. Authorities leading to this conclusion are numerous. See the cases cited in 2 Bac., 32, and in The King v. Amery, 2 T. R. 515. For the forfeiture is the same for non-user when no property has been held or rights exercised, as for misuser or abuser after the possession of much property and the exercise of extensive rights and credits; and the judgment is the same in both cases. Consequently, the judgment could not direct a seizure of the corporate possessions as a forfeiture for the violation of the charter. Nor is the second ground—that the property falls to the state for the want of an owner, on the dissolution of the corporation—more tenable as a foundation on which to sustain this judgment. For the ownership of the corporation does not cease until its dissolution. And whether it is dissolved by the judgment of seizure or not, until the state has execution on that judgment, is not here very material. For if the corporation is dissolved by the judgment, the judgment must be regularly entered, and have its full effect before the dissolution takes place, and it is not till then that the property can be said to be without an owner. The loss of the property to the corporation is a consequence of the judgment, and it is a contradiction of the first principles of reason—a complete reversal of effect and cause—to make such loss of property a part of the judgment. That which cannot exist until after the judgment, can never be the subject-matter on which the judgment is given. But the better opinion seems to me, that the corporation is not dissolved by the judgment of seizure, but that it exists until the franchises are seized by execution on that judgment. See Kyd Corp., 409, 410, and the authorities there cited. Consequently, the last shadow of a support for this judgment on this ground must vanish.

We have thus far examined the judgment which directs a seizure of the goods and chattels, rights and credits, lands and tenements of the corporation, on the assumed position that they will necessarily fall to the state on the dissolution of the corporation. We shall now inquire into the correctness of this position. In order to elucidate the subject we shall examine it in detail, and in the first place inquire what becomes of the lands and tenements; secondly, what becomes of the goods and

chattels, and thirdly, what becomes of the rights and credits of the corporation? and we shall find that each of these three items is governed by different principles.

First. As to the lands and tenements: "When a corporation is dissolved," says Sir Wm. Blackstone, "the lands and tenements revert to the person or his heirs who granted them to the corporation; for the law doth annex a condition to every such grant, that if the corporation be dissolved the grantor shall have the lands again. The grant is only during the life of the corporation, which may endure forever, but when that life is determined by the dissolution of the body politic, the grantor takes it back by reversion, as in the case of every other grant for life." 1 Bl. Comm., 484. This is the doctrine advanced by Lord Coke, Co. Litt. 13b. See, also, 2 Kyd Cor., 516; 2 Bac., 32; 2 Cruise, 493; Colchester v. Seaber, 3 Burr. 1866. We see but little in the books that contradicts or questions those authorities, and the cases that look a different way maintain that the lands would escheat. 2 Bac. 32. If either of those principles be correct we feel warranted in determining that the corporate lands and tenements cannot be seized into the hands of the state, and certainly not in the manner contemplated by this judgment.

Secondly. As to the goods and chattels: On this subject the books are almost silent. In the argument of Colchester v. Seaber, it is said by Sir Fletcher Norton, on the authority of 1 Ro. Ab. 816, that the goods and chattels go to the crown. An English writer, who has collected together most of the cases on corporations, concludes his remarks on the effect of a dissolution in these words: "What becomes of the personal estate is, perhaps, not decided; but probably it vests in the crown." 2 Kyd on Corp., 516. We do not feel under the necessity of resolving any doubts which may rest on this subject; for if the law were conclusive, that the goods and chattels in this case would vest in the state on the dissolution of the corporation, yet we have already seen that this would not be as a forfeiture, but because they are without an owner, and that the claim of the state could not exist until after judgment; consequently, it is impossible to include them in the terms of the judgment.

Thirdly. As to the rights and credits of the corporation:

These, as applying to the debts, etc., due to the corporation, are supposed to be of considerable amount, and have formed a principal feature in every view of this case. But the importance of the case, arising from the amount in controversy, cannot affect the principles by which it is governed and when those principles are fixed they must be declared, let the consequence to individuals or the community be what it may. That the debts are necessarily lost to the corporation naturally follows from the principles we have examined. For when dissolved they have no existence, and can have no claim to, nor control over, anything whatever. They not only die, but leave no representative behind them. This, in every respect, is the case with aggregate corporations. Sole corporations depend, in this respect, upon principles somewhat different; but with them we have now no concern. But although the debts fall out of the lifeless hands of the corporation at the same time with their real and personal estate, yet when thus out of their hands, they are very different in their natures from the real and personal estate.

Lands and goods have a necessary existence, although they may be without an owner in being or in expectancy. They continue in being and may be made the subject of possession by occupancy. But this is not the case with respect to debts. They have no necessary existence, and are so conclusively personal that they cannot exist without an obligor and obligee, without the possibility of a representative, the obligation ceases. Such appears to be the case on the dissolution of a corporation aggregate. Blackstone says: "The debts of a corporation, either to or from it, are totally extinguished by its dissolution, so that the members thereof cannot recover or be charged with them, in their natural capacities. 1 Bl. Comm., 484; 2 Kyd Corp., 516, uses the same language. 2 Bac., 32, advances nearly the same doctrine, on the authority of Lev., 237; Owen, 73, and 2 And., 107. And this doctrine is either directly or indirectly supported in a variety of cases. See the before-mentioned case of Colchester v. Seaber; also Rex v. Pasmore, 3 T. R. 199; The Mayor, etc., of Scarborough v. Butler, 2 Lev. 237; 4 Com. Dig., 273. If this doctrine be correct, and we find it uncontradicted, the seizure of the rights and credits of the corporation is impossible in the nature of

things, because their existence ceases as the claim of the state commences. But even if they could be seized into the hands of the state they would be unavailing. The debts due to the corporation could not, on any common law principle, be collected by the state or its agent, there being no privity of contract, either in fact or law, between the state and debtor to the corporation. * * *

Thus, in no view of the case, can that part of the judgment which directs a seizure into the hands of the state, of the goods and chattels, rights, credits and effects, lands, tenements and hereditaments of the corporation, be supported.

Affirmed as to seizure of franchises but reversed as to seizure of property.

CHAPTER XV.

FOREIGN CORPORATIONS.

Status of Foreign Corporations.

DOYLE v. CONTINENTAL INSURANCE COMPANY.

94 U. S. 535. 1876.

HUNT, J. The complainant alleges that a license had been granted to the Continental Insurance Company, upon its executing an agreement that it would not remove any suit against it from the tribunal of the state to the federal courts; that in the case of Drake it did, on the tenth day of March, 1875, transfer his suit from the Winnebago circuit of the state to the circuit court of the United States; that Drake thereupon demanded that the defendant, who is secretary of state of Wisconsin, should revoke and annul its license, in accordance with the provisions of the act of 1872; that it is insisted that he has power to do so summarily, without notice or trial; that the complainant is fearful that he will do so, and that it will be done simply and only for the reason that the complainant transferred to the federal court the case of Drake, as above set forth. * * *

A license to a foreign corporation to enter a state does not involve a permanent right to remain. Subject to the laws and constitution of the United States, full power and control over its territories, its citizens, and its business, belong to the state.

If the state has the power to do an act, its intention or the reason by which it is influenced in doing it cannot be inquired into. Thus, the pleading before us alleges that the permission of the Continental Insurance Company, to transact its business in Wisconsin, is about to be revoked, for the reason that it removed the case of Drake from the state to the federal courts.

If the act of an individual is within the terms of the law,

whatever may be the reason which governs him, or whatever may be the result, it cannot be impeached. The acts of a state are subject to still less inquiry, either as to the act itself or as to the reason for it. The state of Wisconsin, except so far as its connection with the constitution and laws of the United States alters its position, is a sovereign state, possessing all the powers of the most absolute government in the world.

The argument that the revocation in question is made for an unconstitutional reason cannot be sustained. The suggestion confounds an act with an emotion or a mental proceeding, which is not the subject of inquiry in determining the validity of a statute. An unconstitutional reason or intention is an impracticable suggestion, which cannot be applied to the affairs of life. If the act done by the state is legal, is not in violation of the Constitution or laws of the United States, it is quite out of the power of any court to inquire what was the intention of those who enacted the law. * * *

The statute of Wisconsin declares that if a foreign insurance company shall remove any case from its state court into the federal courts, contrary to the provisions of the act of 1870, it shall be the duty of the secretary of state immediately to cancel its license to do business within the state. If the state has the power to cancel the license, it has the power to judge of the cases in which the cancellation shall be made. It has the power to determine for what causes and in what manner the revocation shall be made.

It is said that we thus indirectly sanction what we condemn when presented directly; to wit, that we enable the state of Wisconsin to enforce an agreement to abstain from the federal courts. This is an "inexact statement." The effect of our decision in this respect is that the state may compel the foreign company to abstain from the federal courts, or to cease to do business in the state. It gives the company the option. This is justifiable, because the complainant has no constitutional right to do business in that state; that state has authority at any time to declare that it shall not transact business there. This is the whole point of the case, and, without reference to the injustice, the prejudice, or the wrong that is alleged to exist, must determine the question. No right of the

complainant under the laws or Constitution of the United States, by its exclusion from the state, is infringed, and this is what the state now accomplishes. There is nothing, therefore, that will justify the interference of this court.

Reversed.

LEADING ILLUSTRATIVE CASES LAW OF PARTNERSHIP

CHAPTER I.

DEFINITION, CHARACTERISTICS AND TESTS OF A PARTNERSHIP.

Nature of a Partnership.

BURT v. LATHROP et al.

52 Mich. 106, 17 N. W. 716. 1883.

CAMPBELL, J. Plaintiff sued a large number of defendants as jointly liable to him for his services as attorney in defending some patent suits concerning the rights to use certain hard-rubber material in dentistry. He declared specially and with the common counts for these services, and also set up two judgments rendered in Jackson county for the same causes of action. Upon trial court below ordered a verdict for defendants. The counts which describe the judgments do not set them out in such a way as to make out any legal liability under them against all these defendants, and the proofs are not any more definite. It appears affirmatively that no jurisdiction existed to bind more than a part of them, and there can be nothing claimed for them under the issue as presented. They may, therefore, be laid aside. The ground for asserting a claim against the defendants jointly is that they are claimed to have become members of an association combined for the purpose of legal resistance to the claims of a patentee, and that plaintiff was employed by their officers.

There is no testimony tending to show any immediate personal employment of plaintiff by the defendants, jointly or individually, so as to justify this joint action. But it was claimed that they stood on the footing of partners, bound by the action of their designated managing members. The testimony indicates that several of the defendants, at various times,

became members of an association which, so far as pertinent to this inquiry, required them to pay five dollars each into the treasury, and to pay such assessments as should be levied pro rata, on pain of being left out of the association and its privileges. The officers were to employ counsel, and money was to be paid on the order of the president and secretary.

We can find in this arrangement nothing analogous to a partnership. There was no common business, and nothing involving profit and loss in a business sense. No one was empowered to make contracts binding on the subscribers personally, and no one was to be liable except for assessments, nor even for those except as he saw fit to pay them to keep his membership. It was nothing more than a combination which may have made the parties in some respects responsible to each other, but which did not, we think, authorize any contract with third persons which should bind any member personally beyond his assessments. As plaintiff was not only aware of the articles, but showed that he acted under them and in furtherance of them in various ways, no question arises in the nature of an equitable estoppel. We are not concerned on this record whether plaintiff has any other adequate means of securing compensation. The only question now is whether these defendants are his joint debtors. We think they are not.

Judgment affirmed.

Partnership as to Third Persons—Exceptions.

LEGGETT et al. v. HYDE et al.

58 N. Y. 272, 17 Am. Rep. 244. 1874.

Appeal by defendant George M. Hyde from judgment of the General Term of the Supreme Court in the Second Judicial Department, affirming a judgment in favor of plaintiffs entered upon a verdict, and affirming order denying motion for a new trial. This action was brought against defendants, who were alleged to be members of the firm of A. D. Putnam & Co., to recover for goods sold and delivered to that firm. Defendant Hyde denied that he was a partner. At the close of the evidence the counsel for defendant Hyde asked the court to direct a verdict in his favor, which was denied. The court, upon request

of plaintiffs' counsel, directed a verdict in favor of plaintiffs, to which defendant's counsel excepted. A verdict was rendered accordingly.

FOLGER, J. At the trial each party asked the court to direct a verdict in his favor. Each thereby conceded that there could be no dispute upon any question of fact. Each thereby conceded that there was left for decision only a question of law, and that it arose upon a settled and uncontradicted state of facts.

Taking the view of the testimony the most favorable for the appellant, the facts are these: In 1869 one Putnam and one Henneberger were partners in business, under the firm name of A. D. Putnam & Co. In that year the appellant invested or deposited with that firm $1,500. This sum was credited on its books to Fredk. Hyde, the son of the appellant. For this sum the appellant was to share in the profits of the business of the firm. His share was to be one-third, and demandable by him at the end of the year. At the end of the year his share of the profits was $500. This sum was also placed to the credit of Fredk. Hyde. Then, in 1870, the appellant loaned to the firm for one year the original sum of $1,500 and the $500 of profits, thus making $2,000. In the consideration of this loan the firm agreed to hire Fredk. Hyde as clerk, at $10 per week, for the year; to pay the appellant one-third of the profits, which were to be settled half-yearly; and, at the end of the year to take him in as a partner, if the firm and he should feel satisfied, on his making further investments and putting in more capital. Though it is nowhere in the testimony so stated in terms, yet it is fairly to be inferred that the $2,000 was loaned to be used in the business, and that if at the end of the year the appellant did not become an ostensible partner he was to be repaid, out of the concern, the $2,000, but without interest, strictly as such. The appellant never interfered in the affairs of the concern, nor exercised any control in the business. At the end of the first six months there were no profits of the business. The appellant never received anything for his $2,000, nor anything by way of interest money.

The prominent and important facts are that he loaned the firm a sum of money to be employed as capital in its business, and that therefor he was entitled to have and demand from it

one-third of the profits of its business every half year. In my judgment there results from this that Putnam and Henneberger, making use of that money as capital in that business, used it there for the benefit of the appellant, because any return to him, for the loan to them, must come from the use of it. If not used so that profits were made, he got no return. Further: That he had an interest in the profits, which, while they were anticipatory, was indefinite as to amount, but, when they were realized, was measured and specific as to share. Further: That his interest in them was in them as profits; that is, that he had a right on the lapse of every six months, though having no property in the whole capital, to have an account taken of the business, and a division made of the profits then appearing. Ex parte Hamper, 17 Vesey, 403. So it is said in Everett v. Coe, 5 Denio, 182: "If he is to be paid out of profits made, then he has a direct interest in them." And see Ogden v. Astor, 4 Sandf. 321, 322. That he had this right to an account and a division at other times than at the end of each six months, if at any other time the exigencies of the concern, as the dissolution of the firm by death of one partner, or other reason, required an account to be taken. He had that interest in the profits, as profits, because he could claim a share of them specifically, as they should appear on each six months, or other accounting of the business of the term then ended, and could then have and demand payment of his share. By the terms of his contract with the firm, if it be upheld as made, he was interested in and affected by the results only of the year, as ascertained at the end of each six months. It would not affect him in the right to account, though the business of a previous year had been disastrous. If either six months' business should yield a profit, he could insist on payment to him of one-third thereof, and could demand that an account be had of the business of any six months to ascertain if there had been profit. It was one-third of the profits that he was to have, and not a sum in general equal to that one-third. So that he was to take it as profits, and not as an amount due; not as a measure of compensation, but as a result of the capital and industry.

The learned counsel for the appellant states the question of law to be this: Does a loan of money, with an agreement for compensation from the profits of the business, per se constitute

the lender a partner quoad the creditors of the firm? Is this statement of it correct? Does the phrase "compensation from the profits" fully meet case? Does it fully present the fact that by the agreement the appellant obtains an interest in the profits as such, and a right to insist upon an accounting, and a division thereof half-yearly? With this supplement, the question for decision is as stated by him. I am not to say what I think ought to be the answer to it, was this a case of first impression. I am to declare what I ascertain to be the answer already given by the law in this state, as it has been settled and declared by the authorities. The argument of the learned counsel is very ingenious, and very forcible when considered in reference to what should be the proper rule, and what the true reasons upon which a rule should be founded. Yet, if it is found that by a long course of decisions, or by long acquiescence in and adherence to, a rule some time ago authoritatively promulgated, there has been established a principle of commercial law upon which the community has acted, it is the duty of the courts to adhere thereto, leaving it to the law-making power to find a remedy, if remedy be needed, in a positive alternative enactment. In England this has been done, and by an act of Parliament an important change has been made. St. 28 & 29 Vict. c. 86.

In the first place, it matters not that the defendants meant not to be partners at all, and were not partners inter sese. They may be partners as to third persons notwithstanding. Manhattan Brass Co. v. Sears, 45 N. Y. 797, 6 Am. Rep. 177. And this effect may result, though they should have taken pains to stipulate among themselves that they will not, in any event, hold the relation of partners. Among the reasons given is this, whether it be strong or weak: That whatever person shares in the profits of any concern shall be liable to creditors for losses also, since he takes a part of the fund, which in great measure is the creditors' security for the payment of the debts to them. Waugh v. Carver, 2 H. Bl. 235, citing Grace v. Smith, 2 W. Bl. 998. The doctrine took its rise in the decisions in these cases. And commenting upon them, the text-writers, who have presented most forcible criticisms upon it, say: "The principle laid down by De Grey, C. J., in Grace v. Smith, has served as the foundation of a long line of decisions which cannot now be overruled by any authority short of that of the Legislature.

* * * And in all cases in which there is no incorporation, nor limited liability, it must still be regarded as binding on the courts." Lindley on Part. *36. "The doctrine is completely established upon the very ground asserted in Grace v. Smith." Story on Part. § 36, note 3. And so Mr. T. Parsons, in his book on Partnership, quoting Lord Eldon, Ex parte Hamper: "But if he has a specific interest in the profits themselves, as profits, he is a partner"—adds: "Undoubtedly he is. Every principle of the law of partnership leads to this conclusion." He contends, however, that the specific interest in profits which is to make a person a partner must be a proprietary interest in them, existing before the division of them into shares. See, also, 3 Kent's Commentaries, *25, note b, where it is said: "The test of partnership is a community of profit; a specific interest in the profits, as profits, in contradistinction to a stipulated portion of the profits as a compensation for services." The courts of this state have always adhered to this doctrine and applied or recognized it in the cases coming before them. * * *

It is not too much to say, that the limited partnership act, 1 Rev. St. (1st Ed.) p. 764, pt. 2, c. 4, tit. 1, is a legislative and practical recognition of this rule of commercial law. Indeed, if it shall be held that such a contract as that of the appellant does not make him a partner as to third persons, there is little or no need of that act. The situation of the special partner is more onerous than that of the appellant under such a ruling. The first may lose his capital invested, as well as profits, by the same being absorbed in the payment to creditors. The latter may lose his anticipated compensation for his money loaned; but his position is quite as favorable to him as that occupied by creditors for the recovery of his money advanced. Neither may interfere, to transact business, or to sign for the firm, or to bind the same. Both may advise as to the management. Both may examine into the state and progress of the partnership concerns—the special partner, from time to time; the appellant, at the end of every six months. In one respect the special partner is better placed. He may stipulate for legal interest on his capital invested, as well as for a portion of the profits. The appellant, if he bargained for profits in addition to interest, might be in conflict with the usury act. It is evident that most of the conveniences and advantages of the limited partnership

act, and some which it does not give, might be obtained by a loan of money, with a stipulation for compensation for its use by a share of the profits, if thereby a partnership is not created as to third persons. This is not decisive as to what the law is; but it is strongly indicative of the view of the law held by the revisers and by the Legislature.

There have been from time to time certain exceptions established to this rule in a broad statement of it; but the decisions by which these exceptions have been set up still recognize the rule that, where one is interested in profits as such, he is a partner as to third persons. These exceptions deal with the case of an agent, servant, factor, broker, or employe, who, with no interest in the capital or business, is to be remunerated for his services by a compensation from the profits, or by a compensation measured by the profits; or with that of seamen, on whaling or other like voyages, whose reimbursement for their time and labor is to finally depend upon the result of the whole voyage. There are other exceptions, like tenants of land, or a ferry, or an inn, who are to share with the owners in results, as a means of compensation for their labor and services. The decisions which establish these exceptions do not profess to abrogate the rule—only to limit it.

It is claimed by the learned counsel for the appellant that the rule as announced in Grace v. Smith and Waugh v. Carver has been exploded, and another rule propounded which shields the appellant. He is correct so far as the courts in England are concerned. Cox v. Hickman, 8 H. of L. C. 268, 9 C. B. N. S. (99 E. C. L.) 47, and Bullen v. Sharp, L. R. 1 Com. Pl. 86, affirm that while a participation in the profits is cogent evidence that the trade in which the profits were made was carried on in part for or in behalf of the person claiming the right to participate, yet that the true ground of liability is that it has been carried on by persons acting in his behalf. Those cases were very peculiar in their circumstances. After the judgments rendered in them, the Parliament deemed it needful to enact that the advance of money by way of loan to a person in trade for a share of the profits should not, of itself, make the lender responsible as a partner. St. 28 & 29 Vict. c. 86, as cited in Parsons on Partn. *92, note t. If the decisions in the cases cited went as far as is claimed, it would seem that the act was supererog-

atory. It is suggested, however, by Kelly, C. B., in Holme v. Hammond, L. R. 7 Exch. 218, that the effect of the statute is that the sharing in the profits by a lender shall be no evidence at all of a partnership. At all events, those decisions have been accepted in England as settling the rule as above stated. See case last cited and cases therein referred to.

Without discussing those decisions and determining just how far they reach, it is sufficient to say that they are not controlling here, that the rule remains in this state as it has long been, and that we should be governed by it until here, as in England, the Legislature shall see fit to abrogate it.

The references upon the appellant's points do not show that the courts of this state have yet exploded the rule I have stated. I have consulted all the authorities cited (save a few of which I had not the books, or as to which there was a miscitation), and I do not find that the rule is questioned, further than to apply to the facts of the particular case some one or more of the exceptions to the rule which I have stated to exist.

I am of the opinion that the judgment appealed from should be affirmed, with costs.

CHURCH, C. J., dissents.

Tests of Intention—In General.

BEECHER et al. v. BUSH et al.

45 Mich. 188, 7 N. W. 785, 40 Am. Rep. 465. 1881.

COOLEY, J. The purpose of the action in the court below was to charge Beecher as partner with Williams for a bill of supplies purchased for the Biddle House in Detroit. Beecher was owner of the Biddle House, and Williams proposed in writing to "hire the use" of it from day to day, and open and keep it as a hotel. Beecher accepted his proposals and Williams went into the house and began business, and in the course of the business made this purchase. The proposals are set out in full in the special verdict. The question is whether by accepting the proposals Beecher made himself a partner with Williams in the hotel business; and this is to be determined on the face of the writing itself. It is conceded that Beecher was never held out

to the public as a partner, and that the bill of supplies was purchased on the sole credit of Williams and charged to him on the books of the plaintiffs below. The case, therefore, is in no way embarrassed by any questions of estoppel, for Beecher has done nothing and suffered nothing to be done which can preclude him from standing upon his exact legal rights as the contract fixed them.

Nor do we understand it to be claimed that the parties intended to form a partnership in the hotel business, or that they supposed they had done so, or that either has ever claimed as against the other the rights of a partner. It is perfectly clear that many things which are commonly incident to a partnership these parties meant should be wholly excluded from their arrangement. Some of these were of primary importance. It is plain, for example, that Beecher did not understand that his credit was to be in any way involved in the business, or that he was to have any interest in the supplies that should be bought, or any privilege to decide upon them, or any legal control whatever until proceeds were to be divided, or any liability to losses if losses were suffered. These are among the common incidents to a partnership; and while some of them, and possibly all of them, may not be necessary incidents, yet the absence of all is very conclusive that the parties had no purpose whatever to form a partnership, or to give to each other the rights and powers, and subject each other to the obligations of partners. In general this should be conclusive. If parties intend no partnership the courts should give effect to their intent unless somebody has been deceived by their acting or assuming to act as partners; and any such case must stand upon its peculiar facts and upon special equities. * * *

We have then a case in which the party it is sought to charge has not held himself out, or suffered himself to be held out as a partner either to the public at large or to the plaintiff, and has not intended to form that relation. He is not therefore a partner by estoppel nor by intent; and if he is one at all, it must be by construction of law. What, then, are the indicia of partnership in this case—the marks which force that construction upon the court irrespective of the intent of the parties, that in fact control their intent and give to the parties bringing suit rights which they were not aware of when they sold the supplies? In

the elaborate and able brief which has been presented in behalf of the defendants in error it is conceded that the fact that Beecher was to receive each day a sum "equal to one-third of the gross receipts and gross earnings" for the day would not necessarily make him a partner. What is claimed is that the fact is "cogent evidence" that Beecher was to participate in the results of the business in a manner that indicated he was a principal in it, and was not receiving compensation for the use of property merely. The view of the law here suggested is undoubtedly correct. There may be a participation in the gross returns that would make the receiver a partner, and there may be one that would not. The question is in what capacity is participation had. Gross returns are not profits and may be large when there are no profits, but it cannot be predicated of either gross returns or profits that the right to participate is conclusive evidence of partnership.

This is settled law both in England and in this country at this time, as is fully shown by the authorities cited for the defendants in error. It was recognized in Hinman v. Littell, 23 Mich. 484; and in New York, where the doctrine that participation in profits proves partnership has been adhered to most closely, it is admitted there are exceptions. Eager v. Crawford, 76 N. Y. 97.

But we quite agree with counsel for defendants in error that no case ought to turn upon the unimportant and mere verbal distinction between the statement in the papers that Beecher was to have a sum "equal to" one-third of the gross receipts and gross earnings, and a statement that he was to have one-third of these receipts and earnings. It is perfectly manifest it was intended he should have one-third of them; that they should be apportioned to him regularly and daily, and not that Williams was to appropriate the whole and pay a sum "equal to" Beecher's proporction when it should be convenient. We can conceive of cases where the difference in phraseology might be important, because it might give some insight into the real intent and purpose of the parties, and throw light upon the question whether that which was to be received, was to be received as partner or only by way of compensation for something supplied to the other, but the intent in this case is too manifest to be put aside by any mere ingenuity in the use of words. Loomis v.

Marshall, 12 Conn. 69, 79, 30 Am. Dec. 596. [The court, after examining numerous cases, continues:]

It is needless to cite other cases. They cannot all be reconciled, but enough are cited to show that in so far as the notion ever took hold of the judicial mind that the question of partnership or no partnership was to be settled by arbitrary tests it was erroneous and mischievous and the proper correction has been applied. Except when one allows the public or individual dealers to be deceived by the appearances of partnership when none exists, he is never to be charged as a partner unless by contract and with intent he has formed a relation in which the elements of partnership are to be found. And what are these? At the very least the following: Community of interest in some lawful commerce or business, for the conduct of which the parties eventually are principals of and agents for each other, with general powers within the scope of the business, which powers however by agreement between the parties themselves may be restricted at option, to the extent even of making one the sole agent of the others and of the business.

In this case we have the lawful commerce or business, namely, the keeping of the hotel. We have also in some sense a community of interest in the proceeds of the business, though these are so divided that all the profits and all the losses are to be received and borne by one only. But where in the eventual arrangements does it appear, that either of the parties clothed the other with an agency to act on his behalf in this business? We speak now of intent merely, and not of any arbitrary implication of intent which the law, according to some authorities, may raise irrespective of and perhaps contrary to the intent. Could Beecher buy for the business a dollar's worth of provisions? Could he hire a porter or a waiter? Could he discharge one? Could he say the house shall be kept for fastidious guests exclusively and charges made in proportion to what they demand, or on the other hand that the tables shall be plain and cheap so as to attract a greater number? Could he persist in lighting with gas if Williams chose something different, or reject oil if Williams saw fit to use it? Was a servant in the house at his beck or disposal, or could he turn off a guest that Williams saw fit to receive or receive one that Williams rejected as unfit? In short what one act might he do or authority exercise, which prop-

erly pertains to the business of keeping hotel, except merely the supervision of accounts, and this for the purpose of accounting only? And how could he be principal in a business over which he had absolutely no control? Nor must we forget that this is not a case in which powers which might otherwise be supposed to exist are taken away or excluded by express stipulation; but they are powers which it is plain from their contract the parties did not suppose would exist, and therefore have not deemed it necessary to exclude.

On the other hand, what single act are we warranted in inferring the parties understood Williams was to do for and as the agent of Beecher? Not to furnish supplies surely, for these it was expressly agreed should be furnished by Williams and paid for daily. Not to contract debts for water and gas bills and other running expenses, for by the agreement there were to be no such debts. Nor was this an agreement merely that expenses incurred for both were to be met without the use of credit, but it was expressly provided that they were to be the expenses of one party only, and to be used by him from his own means. There was to be no employment of credit, but it was the credit of Williams alone that was in the minds of the parties.

It is difficult to understand how the element of agency could be more perfectly eliminated from their arrangements than it actually was. Beecher furnished the use of the hotel and a clerk to supervise the accounts, and received for so doing one-third the gross returns. It was not understood that he was to intermeddle in any way with the conduct of the business so long as Williams adhered to the terms of the contract. If the business was managed badly Beecher might be loser, but how could he help himself? He had reserved no right to correct the mistakes of Williams, supply his deficiencies or overrule his judgments.

He did indeed agree to take and account for whatever furniture should be brought into the house by Williams, but the bringing any in was voluntary, and so far was Beecher from undertaking to pay to the sellers the purchase price, that on the contrary the value was to be offset against the deterioration of that which Beecher supplied; and it was quite possible that, as between himself and Williams, there might be nothing to pay. And while Williams was not compellable to put any in, Beecher,

on the other hand, had no authority to put any in at the cost of Williams.

It is plain, therefore, that if there is any agency in this case for Beecher to act for Williams, or Williams to act for Beecher, it is an agency implied by law, not only without having expressed a purpose that an agency shall exist, but in spite of the plain intent that none shall exist. If therefore we shall say that agency of each to act for the other, or agency of one to act for both in the common business, is to be the test of partnership, or to be one of the tests, but that the law may imply the agency irrespective of the intent, and then imply the partnership from the agency, we see at once that the test disappears from all our calculations. To imply something in order that that something may be the foundation whereupon to erect an implication of something else is a mere absurdity. The test of partnership must be found in the intent of the parties themselves. They may say they intend none when their contract plainly shows the contrary; and in that case the intent shall control the contradictory assertion; but here the intent is plain.

We have not overlooked any one of the circumstances which on the argument were pointed out as peculiar to this case. None of them is inconsistent with the intent that Beecher was to be paid for the use of his building and furniture merely. He retained possession; but a reason for this appears in the power he reserved to terminate the arrangement whenever the contract was broken by Williams. Being in possession, he might suppose he could eject Williams without suit. He might also think it important to the reputation of the hotel that no landlord should be in debt for supplies or for servants' wages; and for that reason require cash payments. It is easy to see that as lessor he might have had an interest in all the stipulations to which Williams' assent was required. [After deciding that defendant could not be treated as a dormant partner, the opinion concludes:]

Our conclusion is that Beecher and Williams, having never intended to constitute a partnership, are not as between themselves partners. There was to be no common property, no agency of either to act for the other or for both, no participation in profits, no sharing of losses. If either had failed to perform his part of the agreement, the remedy of the other would have

been a suit at law, and not a bill for an accounting in equity. If either had died the obligations he had assumed would have continued against his representatives. We also think there can be no such thing as a partnership as to third persons when as between the parties themselves there is no partnership and the third persons have not been misled by concealment of facts or by deceptive appearances.

The judgment must be reversed with costs and a new trial ordered.

CHAPTER II.

CREATION OF A PARTNERSHIP.

Partnership the Result of Intention.

PHILLIPS v. PHILLIPS.

49 Ill. 437. 1863.

CATON, C. J. The only question in this case is one of fact. Was there a copartnership between John Phillips and his four sons, or was he the sole proprietor of the business about which the controversy has arisen? It must be remembered in the outset that this is a controversy inter sese, and is not between third parties and the alleged members of the firm. Parties may so conduct themselves as to be liable to third persons as partners when in fact no partnership exists as between themselves. The public are authorized to judge from appearances and professions, and are not absolutely bound to know the real facts, while the certain truth is positively known to the alleged parties of a firm. A partnership can only exist in pursuance of an express or implied agreement to which the minds of the parties have assented. The intention or even belief of one party alone cannot create a partnership without the assent of the others. If John S. Phillips designed and really believed that there was a partnership, but to which his father and brothers never assented, and in the existence of which they did not believe, then there was no partnership, unless, indeed, a copartnership could be formed and conducted without their knowledge or consent. This would be simply absurd. We cannot in this way surprise them into a partnership of which they never dreamed.

Over twenty years ago John Phillips emigrated from Scotland and settled in Chicago with his family, consisting of a wife and four sons and two daughters. He was then very poor. He was a wood turner by trade, and commenced that business in a very small way with a foot lathe. He was frugal, industrious, and honest, and prospered as but few men, even in this country, prosper. He labored hard with his own hands, and as his sons grew

up they joined their work to his, all except John S., who at a proper age was put as an apprentice to learn the chair maker's trade; but, his health proving delicate, his father made an arrangement with his master by which his time was released when he had but partially learned his trade, when John S. returned home and took a more or less active part in the business of his father. His health was, however, for many years very delicate, and he was enabled to do but little physical labor. He, however, mostly took charge of the office and books, for which the testimony shows he was very well qualified, and where he rendered efficient service. In the meantime the business had grown from the smallest beginning, with a single foot lathe, to a large manufactory, with extensive machinery propelled by steam; and chair making, which was introduced at an early day, had become the principal or largest branch of the business. Thus this business was begun and continued and prospered till 1860, when the complainant left his father and the business, and filed this bill for an account as among partners.

The business had always been conducted, as it was begun, in the name of John Phillips, the father, although in a few instances bills were made out to John Phillips & Sons by persons with but a superficial acquaintance with them, which were paid without eliciting remark or particular attention. The books were all kept in the name of John Phillips, with the exception of a few entries made by a bookkeeper in the name of John Phillips & Sons. Indeed, there is, and can be, no question that, if there was a copartnership embracing the father and sons, the firm name adopted was John Phillips.

The complainant, to show a copartnership, proves that the sons all devoted their time and attention to the business after they attained their majority, without regular salaries as laborers or servants; that funds which they drew from the concern for their support were charged to each one separately, while neither received a credit for labor or services; that the father, upon one or two occasions, stated to third persons that his sons were interested in the business; and he also relies upon the appearances to the outside public and the interest which all took in the success of the business.

For the defense it is claimed that, following the habits and customs of their forefathers in Scotland, the sons continued to

serve the father in the same relation and with the same fidelity after attaining their majority as before, under the distinct and often declared understanding that all should belong to the father during his life, and at his death the business and property should be left by him to his children, as he should think proper. * * * If such was the understanding and purpose of the parties, then there was no partnership. Originally, undoubtedly, the entire concern belonged to the father, and it so continued, unless by the agreement of the father the sons were admitted into the concern as partners; for, as before intimated, we know of no means by which the sons could become partners with the father, and thus acquire a title to his property, without his knowledge or consent. Did the father ever consent that his sons, or either of them, should be admitted as partners with him? Did he ever agree that they should be part owners of this property? On repeated occasions the subject of copartnership with his sons was presented to him, both in the presence of the complainant and his brothers, and he ever repudiated the suggestion in the most emphatic terms. The very suggestion, even, seemed to excite his indignation. Upon one occasion he expressed himself in this characteristic phrase: "Na, na! I will ha' nae sons for partners as long as I live. Damn them! they would put me out of the door." On none of these occasions do we find the complainant, or any of his brothers, claiming the existence of a copartnership; but, on the contrary, they silently acquiesced in the assertions of the father. * * * Had there been ever any agreement, expressed or implied, that there should be a partnership, they, as parties to it, must have been aware of it. If not expressed in words, there must have been at least the mental intention and tacit understanding on the part of the father that they should be admitted as partners, and on their part to assume the benefits and liabilities of partners, and this could not be without their knowledge. Others might be deceived by appearances. Others, ignorant of the customs and traditions of their forefathers, which are so fondly cherished by emigrants from the old country, and particularly from Scotland, might draw erroneous conclusions as to the true relation existing between them as a family, by seeing men in middle life zealously bending their energies under the guidance of their father to the promotion of the success of the business. Whoever should apply

customs prevalent among native Americans to this state of facts would unhesitatingly conclude that all were in partnership. And so, no doubt, many were deceived; nor was it deemed necessary by any of the parties, on all occasions, to undeceive them by a full explanation of this family arrangement.

But the question here is, what was the actual fact; and not what observers supposed was the fact from appearances. It is the internal truth we are seeking, and these external appearances are only important as they may enable us to arrive at this truth; and when we so find the truth by indubitable proof in a different direction than that indicated by these external appearances, then these must go for naught. Here we have the positive testimony of every living man who has the absolute knowledge of the facts, including the complainant himself, all testifying most unqualifiedly that there was no partnership. * * *

Decree is reversed, and the bill dismissed.

CHAPTER III.

THE NAME AND PROPERTY OF A PARTNERSHIP.

The Partnership Name.

HASKINS v. D'ESTE et al.

133 Mass. 356. 1882.

W. ALLEN, J. St. 1877, p. 549, c. 163, provides that "any signature to a written instrument declared on or set forth as a cause of action or ground of defense or set-off, in an action at law, shall be taken as admitted, unless the party sought to be charged thereby shall file in court, within the time allowed for answer, a special denial of the genuineness of such signature and a demand that the party relying thereon shall prove the same at the trial."

The two defendants were sued in a writ which describes them as "late copartners under the firm name and style of D'Este & Co.," and the declaration alleges that they made a promissory note signed "D'Este & Co." One of the defendants, McKenzie, did not appear. The other, D'Este, appeared and filed a general denial. The question is whether the signature is to be taken as admitted to bind D'Este, or whether it is only admitted as the signature of a copartnership of D'Este & Co., and the plaintiff, to hold D'Este, must prove that he was a member of the firm whose signature he admits. The question is precisely what it would have been if both defendants had appeared and filed a general denial in answer. The admission is the same, as to those making it, whether made by both defendants together, or separately, or by one alone.

A partnership is not a person distinct from its members, like a corporation. A partnership cannot be sued. A suit must be against the individuals composing it, and each individual stands, as to proof of his liability, as if he were sued alone. In either case his personal liability upon the joint undertaking would have to be made out, and in either case the allegation of partnership would but express the relation between the copart-

ners; and the relation of copartners to each other, as affects their liability to third persons, is simply one of agency. The allegation that a number of individuals as members of a copartnership made a contract is only the allegation that each of them, personally or by his agent, made it, and the agency is alleged and proved by the copartnership.

In the case at bar the substantial allegation is that each of the defendants made a joint note in the name of D'Este & Co.: that is, that each of them signed that name to the note. The allegation of copartnership amounts only to a statement that each of the defendants was authorized to sign that name for both, and that an agent might be authorized to sign for both. This is the whole significance of the firm name. It is a name which the partners adopted, by which each could, in certain matters, bind the other with himself, or another agent might bind both. It was simply a convenient abbreviation of their two names, and, when used, had the same effect as if no firm name had been adopted and the name of each partner had been signed in full as a partner; and it bound each only because he had adopted it as his name and authorized its use for the purposes for which it was used. When the defendant D'Este admits the genuineness of the signature, he does not admit it to be a mere name. He admits it to be a sign manual, the name of a person signed, and the only question is: Whose name does he admit it to be? The answer is plain. He admits it to be the genuine signature of the persons whose signature it is alleged in the declaration to be. The declaration does not allege that the firm made the note. It alleges that the defendants, D'Este and McKenzie, in the name of D'Este & Co., made—that is, signed—the note; that it is the genuine signature of both in the name they had adopted for binding themselves jointly. It is said that it is not alleged that the note was signed by the defendant D'Este personally and that he may not have been one of the persons doing business under the name of D'Este & Co. But it is alleged that the two defendants, one of whom is D'Este, made the note in that name. If the allegation had been that the defendant D'Este, doing business in the name of John Doe, had made the note in that name, it would hardly be contended that the genuineness of his signature would not be admitted, because there might have been another person doing business in that

name whose signature it might be, nor because the signature might have been made by an agent, and not by the defendant personally. The declaration alleges that the defendants made the note. If the writ is taken in connection with the declaration, there is, so far as the question in issue is concerned, only the further allegation, in effect, that the two defendants held such a relation to each other that each had authorized the other to bind him in a joint note by the name of D'Este & Co. We think the signature is alleged to be that of the defendant D'Este, and that its genuineness, not having been denied, must be taken to have been admitted. See Wilkes v. Hopkins, 1 C. B. 737; Mahaiwe Bank v. Douglass, 31 Com. 170.

In the opinion of a majority of the court, the ruling of the judge that the plaintiff was not entitled to recover was, for these reasons, erroneous.

Exceptions sustained.

Title to Partnership Property—How Taken and Held.

HENDREN et al. v. WING et al.

60 Ark. 561, 31 S. W. 149, 46 Am. St. Rep. 218. 1895.

Replevin by D. R. Wing and others, partners as the Arkansas Machine & Supply Company, against G. H. Hendren and others. Judgment for plaintiffs. Defendants appeal.

The appellees, D. R. Wing, C. E. Stephens, and Joseph Eggleston, are partners doing business under the firm name of Arkansas Machinery & Supply Company. In the course of their business as such firm they sold one E. H. Miller the following machinery: One 35 horse power return tubular boiler, with fixtures and fittings; and one 35 horse power C. & T. engine complete, with fixtures and connections. For this property Miller agreed to pay $906.50, and he gave his notes for that amount, payable in installments. Afterwards, to further secure the payment of these notes, Miller executed a mortgage to said Arkansas Machinery & Supply Company, including in said mortgage the machinery purchased and also other property. Miller at this time was also indebted to appellants, and to secure the same had previously given them a mortgage on another boiler and engine. He disposed of this machinery without appellants'

consent, and replaced it with the machinery in controversy. Appellants obtained possession of the boiler and engine purchased from appellees and claim the right to hold same in lieu of the boiler and engine wrongfully disposed of by Miller. Appellees brought replevin to recover the same. Their action was resisted on the ground that the mortgage to the Arkansas Machinery & Supply Company, under which appellees claimed, did not contain the name of either a natural or artificial person, and was therefore void. The circuit court held that the mortgage was valid, and gave judgment in favor of appellees.

RIDDICK, J. The Arkansas Machinery & Supply Company is not a corporation, but it is a business name of a firm of partners. The question for us to determine is whether a chattel mortgage executed to it as such partnership is valid at law. It was said by Mr. Justice Eakin, in Percifull v. Platt, 36 Ark. 464, that "a partnership as such cannot at law be the grantee in a deed or hold real estate." "The legal title," said he, "must vest in some person, and a partnership is not a corporation. If the title be made to all the partners by name, they hold the legal title as tenants in common. * * * If the deed be to a name adopted as the firm style, which includes the name of no party, it passes nothing at law." He proceeds, then, to say that in equity the rule is different. A deed or mortgage of real estate to partners, describing them only by their firm name, will be enforced in equity, whether such firm name includes the name of one or more of the partners or not. Chicago Lumber Co. v. Ashworth, 26 Kan. 212; Bates, Partn. § 296, and authorities there collated. But, as this is an action at law, it is contended that the strict rule of law with reference to the conveyance of real estate to partnerships must apply. The decisions in regard to transfers of real estate to partnerships are based on the old rule stated by Judge Eakin, that "a partnership, as such, cannot at law be the grantee in a deed or hold real estate." This rule does not apply to personal property. On the contrary, a partnership, as such, can at law be the vendee in a bill of sale or other conveyance of personal property. The custom of the country teaches us that this is so. The business of the country is largely carried on by partners under partnership names which frequently do not contain the name of any person. Vast quan-

tities of personal property of all kinds are contracted for, bought, and sold by such firms under their firm names each year, and their right to thus buy and sell goes unchallenged. A consideration of this fact shows that there is a wide distinction between the rights of partnerships at law in regard to the buying and selling of personal property and the restrictions which prevail therein in regard to transfers of real estate. A mortgage is only a conveyance for the purpose of securing a debt. If a bill of sale conveying personal property to a partnership by its firm name is valid, we see no reason why a mortgage of personal property to a partnership should not be upheld under like circumstances. It is true that the statute requires certain formalities in regard to acknowledging and recording mortgages in order to give notice to third parties. But there is nothing in the statute which renders invalid mortgages of personal property executed to a partnership by its firm name. Such a conveyance to a firm is just as effectual as if the name of each partner had been set out in the mortgage. Henderson v. Gates, 52 Ark. 373, 12 S. W. 780; Kellogg v. Olson, 34 Minn. 103, 24 N. W. 364; Byam v. Bickford, 140 Mass. 32, 2 N. E. 687; Brunson v. Morgan, 76 Ala. 593; Chicago Lumber Co. v. Ashworth, 26 Kan. 212. We therefore conclude that the judgment of the circuit court in regard to the validity of the mortgage was correct, and it is affirmed. * * *

GILLE v. HUNT et al.

35 Minn. 357, 29 N. W. 2. 1886.

GILFILLAN, C. J. Action under the statute to determine adverse claims to real estate, each party claiming the title. July 25, 1856, Jared S. Demman owned the premises, and on that day executed a mortgage thereon to "D. B. Dorman & Co.," containing the usual power of sale, and which was, on the same day, duly recorded. October 7, 1856, Demman conveyed the premises to Peter Poncin, by deed duly recorded the next day. On the same day, evidently either at the same time of or after the execution of this last deed, D. B. Dorman executed to Poncin a deed of quitclaim and release of the premises, which was recorded October 8, 1856. Plaintiff claims under Poncin. "D. B. Dor-

man & Co." was a partnership under that name, composed of D. B. Dorman and Ovid Pinney, though that fact does not appear to have been stated in the mortgage. April 15, 1857, Dorman executed to Pinney an assignment of the mortgage recorded September 13, 1859. In May, 1864, Pinney proceeded to foreclose the mortgage under the power of sale, signing his name to the notice of sale, "Ovid Pinney, Mortgagee and Assignee." At the sale he became the purchaser, and received from the sheriff the usual certificate. The defendants claim under the mortgage and foreclosure.

The case turns mainly on the question, in whom was the legal title to the mortgage; that is, who was in law the mortgagee? Was it D. B. Dorman, or was it the partnership or the parties doing business under the name D. B. Dorman & Co.? A mortgage of real estate, though it is in effect but a lien or security, is in form a conveyance of an estate or interest in land (Morrison v. Mendenhall, 18 Minn. 232 [Gil. 212]), and must be governed by the same rules as to its execution and validity, and the capacity of the parties, and their proper designation, as are applied to a conveyance. It has been affirmed in several cases in this court that the legal title to real estate can be held only by a person, or a corporate entity, which is deemed such in law; and that, therefore, a partnership cannot, as such, take and hold such legal title. Thus, in German Land Ass'n v. Scholler, 10 Minn. 331 (Gil. 260), it was decided that the plaintiff, being only a voluntary association of persons, unincorporated, had no legal capacity to take or hold real property. The rule was recognized in Morrison v. Mendenhall; and in Tidd v. Rines, 26 Minn. 201, 2 N. W. 497, it was decided that a conveyance to a partnership by its firm name did not vest in it any legal title or estate, because a partnership, as such, is not recognized in law as a person; so that even had it been stated in the mortgage that the name inserted as the mortgagee was that of a partnership, it would not have made the partnership mortgagee. Nor, as we think, would the individual partners (other than the one named) be the mortgagee.

It is true that the grantee in a conveyance need not be named, provided he be described with sufficient definiteness and certainty, as where he is indicated by a title, or an office, and there is but one such; as in Lady Superior v. McNamara, 3 Barb. Ch.

(N. Y.) 375, 49 Am. Dec. 184, where a conveyance to the "Lady Superior" of a designated convent was held good to vest the title in a person then lady superior; but the court referred with approval to Duncan v. Beard, 2 Nott & McC. (S. C.) 400, in which it was held that a conveyance to one and his "associates" vested title in none but the person named, the term "associates" being too indefinite to carry the title to the persons intended by it. There are some authorities which seem to hold that such a conveyance would be good to the persons so designated, and that it may be proved by parol who they are; but we think these cases go a great way towards holding that a conveyance of real estate may vest partly in parol, and when we consider the infinite confusion in titles to real estate—in which there ought to be great definiteness and certainty—such a rule might let in, we do not hesitate to decide that the proposition that such a designation is too indefinite and uncertain rests in better reason and authority. Where the style of a partnership is inserted as a grantee, and it contains the name or names of one or more of the partners, there is no reason why the title should not vest in the partners so named; and the authorities are to the effect that it would.

The legal title to the mortgage in question was, then, in D. B. Dorman. He was the only person through whom legal title could be made, under the mortgage. * * *

Judgment affirmed.

Partnership Property—What is Included in Partnership Property.

ROBINSON BANK v. MILLER et al.

153 Ill. 244, 38 N. E. 1078, 27 L. R. A. 449, 46 Am. St. Rep. 883. 1894.

John Newton, John S. Emmons, and Frank O. Miller, having each acquired, with individual funds, a one-third interest in a certain parcel of land containing four acres, entered into an oral agreement of partnership to engage in the business of milling and of buying and selling grain. The business of the firm was done in a mill on said land. John S. Emmons executed two mortgages on his one-third interest in the land—one to

Willis Emmons to secure him as surety on a note of John S. Emmons, and the other to Wiley S. Emmons and William W. Walter to secure them as sureties on another note of John S. Emmons. Frank O. Miller also executed a mortgage on his one-third interest to one Lamport. The Robinson Bank, a creditor of the firm of Newton, Emmons & Miller, claims that the mill property and the land upon which the mill stands was partnership property belonging to Newton, Emmons & Miller as partners; that the individual creditors of Miller and John S. Emmons, such as Willis Emmons, Wiley S. Emmons, and William W. Walter, were only entitled to such surplus as might arise out of the mill property after the payment of the firm debts therefrom. The bank filed a bill seeking to have the mortgages to Wiley S. Emmons, William W. Walter, and Willis Emmons, and to Lamport, set aside. Said mortgagees filed cross-bills asking for the foreclosure of their respective mortgages. In the circuit court the mortgages by John S. Emmons were held to be valid, and a foreclosure was decreed. The mortgage to Lamport was set aside for fraud. This was an appeal by the bank and by Lamport. The validity of the mortgages depends on whether the land on which they were given was the property of the mortgagors individually or whether it belonged to the partnership.

MAGRUDER, J. * * * Whether real estate upon which a partnership transacts its business is firm property or the property of the individual members of the firm is oftentimes a difficult question to determine, and one upon which the authorities are not altogether uniform. The mere fact of the use of land by a firm does not make it partnership property. Geopper v. Kinsinger, 39 Ohio St. 429; Hatchett v. Blanton, 72 Ala. 423. Nor is real estate necessarily the individual property of the members of a firm because the title is held by one member, or by the several members in individual interests. 1 Bates, Partn. § 280. Whether real estate is partnership or individual property depends largely upon the intention of the partners. That intention may be expressed in the deed conveying the land, or in the articles of partnership; but when it is not so expressed the circumstances usually relied upon to determine the question are the ownership of the funds paid for the land, the uses to

which it is put, and the manner in which it is entered in the accounts upon the books of the firm. 1 Bates, Partn. § 280; 2 Lindl. Partn. marg. p. 649; 17 Am. & Eng. Enc. Law, p. 945, and cases in note. Where real estate is bought with partnership funds for partnership purposes, and is applied to partnership uses, or entered and carried in the accounts of the firm as a partnership asset, it is deemed to be firm property; and in such case it makes no difference, in a court of equity, whether the title is vested in all the partners, as tenants in common, or in one of them, or in a stranger. T. Pars. Partn. (4th Ed.) § 265; 1 Bates, Partn. § 281; Johnson v. Clark, 18 Kan. 157; 17 Am. & Eng. Enc. Law, p. 948, and cases cited. If the real estate is purchased with partnership funds, the party holding the legal title will be regarded as holding it subject to a resulting trust in favor of the firm furnishing the money. In such case no agreement is necessary, and the statute of frauds has no application. Parker v. Bowles, 57 N. H. 491; 1 Bates, Partn. § 281.

In the case at bar the land was not purchased with partnership funds. The undivided one-third interest bought by John S. Emmons was paid for by him with his own individual money. Miller also paid for the one undivided one-third interest, purchased by him with his individual funds. None of the money of the firm of Newton, Emmons & Miller was contributed towards the purchase of the one-third interest held by Newton. Indeed, the proof shows that the firm of Newton, Emmons & Miller was formed by an oral agreement after Emmons and Miller had bought their interests. Each partner here held the title to an undivided one-third part of the property. No entries were made upon the books of the firm showing that the real estate was treated as firm assets. The evidence, however, does show that the property was bought for the purpose of being used in the milling business, and that after its purchase it was used for firm purposes, and that the firm gave its notes to pay for repairs, and for placing new machinery in the mill upon the premises. Under these circumstances, was the land partnership property, or the individual property of the partners, holding as tenants in common? It cannot be said that the land is firm property, upon the theory of a resulting trust, because the money of the firm was not used to buy the property. Such a trust might exist in favor of the firm, regarding it as a person, if the partners

had taken the legal title, and the firm had advanced the purchase money. The trust must arise at the time of the execution of the conveyance, and when the title vests in the grantee. Such could not have been the case here, under the facts stated. Van Buskirk v. Van Buskirk, 148 Ill. 9, 35 N. E. 383. In view of the fact that the land was bought with individual, and not partnership, funds, and was conveyed in undivided interests to the several partners, and in the absence of any agreement that it should be regarded as firm property, does the conduct of the parties in afterwards forming a partnership, and using the property for partnership purposes, and repairing and improving the mill at the expense of the firm, make the land firm property, in a court of equity? A negative answer to this question is found in many of the authorities. * * *

The general doctrine of all these cases is that a purchase of the land with partnership funds is necessary to make it firm property. * * *

The weight of authority seems to us to support the position that where persons who afterwards become partners buy land in their individual names and with their individual funds, before the making of a partnership agreement, the land will be regarded as the individual property of the partners, in the absence of a clear and explicit agreement subsequently entered into by them to make it firm property, or in the absence of controlling circumstances which indicate an intention to convert it into firm assets. We do not think that an application of this rule to the facts of the present case shows the real estate here in controversy to be firm property. * * *

Decree affirmed.

Nature and Extent of Partner's Interest in Partnership Property.

TAYLOR et al. v. FIELD.

4 Ves. 396 (Eng.). 1799.

The point in this cause depended upon the general question whether a separate creditor of one partner can hold the partnership effects taken under an execution for his separate debt against the joint creditors of the partnership.

At the time the execution took place the partnership was insolvent; but a commission of bankruptcy had not then issued.

The court having taken some time to consider, the LORD CHIEF BARON delivered their opinion.

The right of the separate creditor under the execution depends upon the interest each partner has in the joint property. With respect to that we are of opinion that the corpus of the partnership effects is joint property, and neither partner separately has anything in that corpus, but the interest of each is only his share of what remains after the partnership accounts are taken.

In Skipp v. Harwood, 1 Ves. 239 (sub nom. West v. Skipp), we see that, whatever the right of the partnership may be, it is not affected by what may happen between the individual partners. There is a distinction between the rights of the partners and the rights of the partnership. As between one partner and the separate creditors of the other, they cannot affect the joint stock any farther than that partner whose creditors they are could have affected it. In Fox v. Hanbury, Cowp. 445, Lord Mansfield was led to the consideration of a point that bears much upon this case; and, adverting to the case of Skipp v. Harwood, he states a passage of Lord Hardwicke's judgment from his own note rather stronger than it appears in the report: "If a creditor of one partner takes out execution against the partnership effects, he can only have the undivided share of his debtor, and must take it in the same manner the debtor himself had it, and subject to the rights of the other partner."

What is the manner in which the debtor himself had it? He had that which was undivided, and could only be divided by first delivering the effects from the partnership debts. He who comes in as his companion, as joint-tenant with him, according to this doctrine of Lord Hardwicke, must take it in the same manner the debtor himself had it, subject to the rights of the other partners.

Lord Mansfield having stated what, according to the course of the common law, as far as it respects trade between partners, is the rule, that a creditor taking out execution against a partner is directly in the place of the partner debtor, proceeds to show that by the same rule, where a partner becomes bankrupt, the assignees are put in the place of the partner, in whose right

they come in, and by no means, as was argued by Mr. Plumer, by any rule arising out of the bankrupt laws; for nothing is said in any one of those acts as to the creditors of a partnership and the separate creditors of one partner, but they only provide for the case of mutual debts and accelerating a debt upon a security payable at a future day. But the same common law, applied in the case where one partner becomes a bankrupt, provides that the assignee of the bankrupt shall be in the same situation as that in which a creditor taking out execution stood before those acts. This introduces all the cases of bankruptcy, which Mr. Plumer wished to exclude, as not applicable to a case in which there was no bankruptcy; and this case is to be considered as if no bankruptcy had taken place, as the execution was before the bankruptcy. In law there are three relations: First, if a person chooses for valuable consideration to sell his interest in the partnership trade, for it comes to that; or if his next of kin or executors take it upon his death; or if a creditor takes it in execution, or the assignees under a commission of bankruptcy. The mode makes no difference; but in all those cases the application takes place of the rule that the party coming in the right of the partner comes into nothing more than an interest in the partnership, which cannot be tangible, cannot be made available, or be delivered, but under an account between the partnership and the partner, and it is an item in the account that enough must be left for the partnership debts. * * *

The question, therefore, recurs to the consideration, what it was that partner had, for the creditor cannot be entitled to any more. It therefore argues nothing to say he has the merit of diligence, till we see upon what that merit can attach. If the partner himself, therefore, had nothing more than an interest in the surplus beyond the debts of the partnership upon a division, if it turns out that at common law that is the whole that can be delivered to, or taken by, the assignee of a partner, the executor, the sheriff, or the assignee under a commission of bankruptcy, all that is delivered to the creditor taking out the execution is the interest of the partner in the condition and state he had it; and nothing was due to this partner separately, the partnership being insolvent. The whole property was due to the partnership creditors, and not to either partner.

Conversion of Partnership Realty Into Personalty.

DARBY v. DARBY et al.

3 Drew. 495 (Eng.). 1856.

Alfred Darby and Abraham Darby embarked in a joint speculation as partners in the purchase of real estate, to be laid out in building sites and resold for their joint profit. There was no actual deed or written instrument of partnership. While the arrangement continued, and while a large portion of the land thus bought remained unsold, Alfred Darby died.

This was a bill filed by his administratrix for the administration of his estate. The principal question was whether Alfred Darby's share of the unrealized real estate descended to his heir at law, or whether it passed as personal estate to his personal representative.

SIR R. T. KINDERSLEY, V. C. [after reviewing the English cases]. The result, then, of the authorities may be thus stated: Lord Thurlow was of opinion that a special contract was necessary to convert the land into personalty; and Sir W. Grant followed that decision. Lord Eldon on more than one occasion strongly expressed his opinion that Lord Thurlow's decision was wrong. Sir J. Leach clearly decided in three cases that there was conversion out and out; and Sir L. Shadwell, in the last case before him, clearly decided in the same way. That is the state of the authorities.

Now it appears to me that, irrespective of authority and looking at the matter with reference to principles well established in this court, if partners purchase land merely for the purpose of their trade, and pay for it out of the partnership property, that transaction makes the property personalty, and effects a conversion out and out.

What is the clear principle of this court as to the law of partnership? It is that on the dissolution of the partnership all the property belonging to the partnership shall be sold, and the proceeds of the sale, after discharging all the partnership debts and liabilities, shall be divided among the partners according to their respective shares in the capital. That is the general rule.

It requires no special stipulation. It is inherent in the very contract of partnership. That the rule applies to all ordinary partnership property is beyond all question, and no one partner has a right to insist that any particular part or item of the partnership property shall remain unsold, and that he shall retain his own share of it in specie. This principle is clearly laid down by Lord Eldon in Crawshay v. Collins, 15 Ves. 218, and by Sir W. Grant, in Featherstonhaugh v. Fenwick, 17 Ves. 298, and the right of each partner to insist on a sale of all the partnership property, which arises from what is implied in the contract of partnership, is just as stringent as a special contract would be. If, then, this rule applies to ordinary stock in trade, why should it not apply to all kinds of partnership property? Suppose that partners, for the purpose of carrying on their business, purchase out of the funds of the partnership leasehold estate, or take a lease of land, paying the rent out of the partnership funds; can it be doubted that the same rule which applies to ordinary chattels would apply to such leasehold property? I do not think it was ever questioned that, on a dissolution, the right of each partner to have the partnership effects sold applies to leasehold property belonging to the partnership as much as to any other stock in trade. No one partner can insist on retaining his share unsold. Nor would it make any difference in whom the legal estate was vested, whether in one of the partners or in all. This court would regulate the matter according to the equities. And Sir W. Grant so decided in Featherstonhaugh v. Fenwick.

If, then, the rule applies, not only to ordinary stock in trade, but also to a lease for years, suppose, next, that the partnership, instead of purchasing a term of years, were (whether from necessity or choice) to purchase land in fee; if the land is necessary for the partnership business, and bought with the partnership assets, what difference can it make whether the real estate bought is leasehold or in fee? Let it be once established that the property purchased is partnership property and it then comes under the operation of those principles which arise out of the partnership contract; and there seems to be no reason why the operation of those principles is to be restricted to any particular class or species of partnership property. The observations of Lord Eldon in Crawshay v. Maule, 1 Swanst. 495, show that in his opinion the right to a sale on a dissolution of partnership does not in any

degree depend on the nature of the property. Nor could it be material in this case, any more than on the purchase of a leasehold interest, in whom the legal estate was vested.

I should, therefore, feel no hesitation in coming to this conclusion: That the mere contract of partnership, without any express stipulation, involves in it an implied contract, quite as stringent as if it were expressed, that at the dissolution of the partnership all the property then belonging to the partnership, whether it be ordinary stock in trade, or a leasehold interest, or a fee-simple estate in land, shall be sold, and the net proceeds, after satisfying all the partnership debts and liabilities, be divided among the partners, and that each partner, and the representatives of any deceased partner, have a right to insist on this being done.

Next, what is the doctrine of this court as to conversion? If a testator seised of real estate devises it for sale, and directs that the proceeds of the sale shall be divided among certain persons, so that each of the cestuis que trustent is entitled to say he will have it sold and will take his share of the proceeds, that real estate is in equity converted into personalty; and so, if three persons contract that certain real property belonging to them shall be sold, and the proceeds be divided among them, so that each one of them has a right to insist that it shall be sold, and that he shall have his share of the proceeds as money, that real property is in equity converted into personalty, and if any one of them dies while the property remains unsold his share is personalty, as between his heir and his personal representatives.

Now, if it be established that by the contract of partnership all the partnership property is to be sold at the dissolution of the partnership, then any real property which has become the property of the partnership becomes, by force of the partnership contract, converted into personalty; and that, not merely as between the partners, to the extent of discharging the partnership debts, but as between the real and personal representatives of any deceased partner.

That this is so I should, in the absence of all authority, have decided upon the principle; and when I find, notwithstanding the decision of Lord Thurlow, followed by Sir W. Grant, that Lord Eldon was clearly of opinion that real property purchased by a partnership for the partnership purposes and with the part-

nership funds becomes personalty, that Sir J. Leach repeatedly so decided without any doubt, and that Sir L. Shadwell also decided the last case in the same way, I can have no difficulty in coming to the conclusion that, whenever a partnership purchases real estate for the partnership purposes and with the partnership funds, it is, as between the real and personal representatives of the partners, personal estate.

Now, this case is not the ordinary case where persons carrying on the ordinary business of a commercial or manufacturing partnership have found it necessary to purchase real estate for partnership purposes. That is not the case. Here they bought land as the stock in trade, by the sale of which they were to make their profits. The land was not in the nature of plant, but was the very subject-matter of their trade. Does that make any difference? If it does, I think it is in favor of treating it as converted, because the real estate is here clearly put in the same position as ordinary stock in trade; and it appears to me that, if I entertained more doubt than I do on the general question, that doubt would in this case be very much diminished by the circumstance that here the real estate is itself bought for the very purpose of selling it again. The very intention of the partnership was to buy land to resell it. That is their very contract, and without selling the land again there would be no partnership business. The partnership was for the purpose of buying land to parcel it out in plots, and to sell them again, and each partner had a right to say he would have that contract carried out. We have here what Lord Thurlow wanted in Thornton v. Dixon, an actual contract that the land shall be sold.

I must, therefore, decide that the share of A. Darby was personal estate, and passed to his personal representatives.

Effects of Death of Partner on Partnership Property.

ANDREWS' HEIRS v. BROWN'S ADM'S.

21 Ala. 437, 56 Am. Dec. 252. 1852.

Bill by Thomas Brown, the surviving partner of the firm of E. L. Andrews & Co., against the representatives and heirs of E. L. Andrews and Z. Andrews, the deceased partners, for the purpose of obtaining control of certain stock and real estate

standing in the name of the deceased partners and subjecting it to the partnership debts. The bill alleged that the property, although standing in the names of the defendants individually, was partnership property, and also the insolvency of the firm. The property had belonged formerly to a firm composed of E. L. and Z. Andrews, and when the firm with Brown as a member was formed the land was carried into the new firm and became part of the capital. A supplemental bill was filed, stating that part of the real estate had been purchased by E. L. Andrews for the firm at a foreclosure sale, and the property had been redeemed, and the money paid to Campbell & Chandler, attorneys for the deceased partners, and prayed that this be decreed to stand in place of the land itself. The chancellor decreed in favor of the complainant. Defendant brought error.

DARGAN, C. J. When a partnership is dissolved by the death of one or more of the partners, the legal title to all the personal property and choses in action belonging to the firm becomes vested exclusively in the survivor; not, indeed, for his own peculiar benefit, but for the purpose of paying the debts, and then dividing the net balance amongst those entitled, giving to the representatives of the deceased partner the same interest he would have taken had he been in life, and the firm had been dissolved, not by death, but by mutual consent. But as respects real property the case is different at law; for the legal title descends to the heir at law of the deceased partner, and a court of law, looking to the legal title alone, cannot regard or protect the mere equities of others. In a court of equity, however, real estate belonging to the firm is considered as personal property to this extent, at least: that it is liable to pay the debts of the firm, and then to distribution between the partners in the same manner as if it had been personal instead of real estate. These charges upon the real estate, being prior to the claims of the representatives of the deceased partner, override his wife's title to dower, as well as the title of his heir at law. The consequence is that the heir at law holds the legal title subservient to or in trust for the surviving partner, who is charged with the payment of the debts. These principles of law, in my opinion, are so well settled that they are no longer the subject of controversy. Story on Partn. 127 et seq., Coll. on Partn. (Perkin's Ed.)

183-185; Pugh v. Currie, 5 Ala. 446; Pierce v. Trigg, 10 Leigh (Va.) 406; Delmonico v. Guillaume, 2 Sandf. Ch. (N. Y.) 366; Dyer v. Clark, 5 Metc. (Mass.) 562, 39 Am. Dec. 697; Ripley v. Waterworth, 7 Ves. 425; Dale v. Hamilton, 5 Hare, 369.

Inasmuch as the real estate is considered as personal for the purpose of paying the debts of the firm, and the surviving partner is charged with the duty of paying those debts, it must of necessity follow that he has the right in equity to dispose of the real estate for this purpose; for it would never do to charge him with the duty of paying the debt, and at the same time to take from him the means of doing it. Therefore, although he cannot by his deed pass the legal title to the purchaser, which descended to the heir of the deceased partner, yet, as the heir holds the title in trust to pay the debts, and the survivor is charged with this duty, his deed will convey this equity to his purchaser, and through it he may call on the heir for the legal title and compel him to convey. See Delmonico v. Guillaume and Dyer v. Clark, supra.

Applying these principles to the facts exhibited by the pleadings and proof in the case before us (but which we will not state in detail in this opinion), we can perceive no error in the decree; for the proof, we think, is abundant to show that, although the legal title to the lands was held by E. L. Andrews alone, nevertheless they belonged to the firm as partnership property, and were so treated by all the members of the firm. They never did belong exclusively to E. L. Andrews. Consequently the claims of the creditors of the firm are superior to his widow's right of dower, as well as to the legal title of his heirs at law. The lands were purchased with the funds of E. L. & Z. Andrews, who were then partners, and stood upon their books as partnership property, and when the new firm was formed, composed of E. L. and Z. Andrews and Thomas G. Brown, these lands were carried into the new firm as part of its capital, and were therefore partnership property.

As to the stocks purchased with the funds of the new firm, it is very clear that they also are subject to the control and disposition of the surviving partner, Brown, notwithstanding they stand on the books of the bank and the insurance company in the name of E. L. Andrews alone. In reference to the money received by Messrs. Campbell & Chandler, growing out of the redemption of

one of the lots by Mr. Gliddon, we think it should stand in the place of the lot itself, and consequently subject to the disposition made by Brown of the lot.

We are satisfied there is no error in the decree, and it must be affirmed.

I will observe, in conclusion, that we do not intend, by anything said in the foregoing opinion, to hold that a surviving partner is authorized to sell real estate for the simple purpose of making distribution amongst the partners themselves and their representatives. That question is not raised in the case, and has not been considered. We only intend to decide this: The firm being insolvent, the surviving partner may dispose of the whole property to pay the debts, whether that property consist of real or personal estate.

The decree is affirmed.

CHAPTER IV.

NATURE, EXTENT AND DURATION OF PARTNERSHIP LIABILITY.

Extent of Partner's Liability for the Firm Debts.

BENCHLEY v. CHAPIN.

10 Cush. 173 (Mass.). 1852.

SHAW, C. J. The petitioner sets forth that he was duly appointed assignee under proceedings in insolvency against John Leland, an insolvent debtor. Amongst the assets of the estate was a promissory note, given by Benchley & Jackson, a firm of which Benchley, the petitioner, was a partner, secured by a mortgage of real and personal property. Before a dividend, and without authority from the commissioner, the assignee sold this note and mortgage, at public auction, for about half the par value, and credited the proceeds in his account. The commissioner rejected this credit, and required him to credit the estate with the whole amount of the note as of a debt due from himself. The object of this petition of the assignee to this Court is to obtain a reversal of this order, and authorize him to discharge himself from all further liability to the estate of the insolvent on this note, by accounting for the proceeds of the sale.

The Court are of opinion that the decision of the commissioner was right. Each partner is liable *in solido* for the entire debt. The assignee was debtor to the estate, of which he himself was sole representative and trustee, for the whole debt. He had no release or discharge of any sort, and no proceedings in insolvency had been commenced indicative of his inability to pay the whole debt.

In the first place, it seems very clear that if he could sell his own debt, as he could other choses in action, this sale was premature, irregular, and void. But suppose it valid, what did he sell? Certainly, a right to recover the whole debt. At whatever dis-

count the purchaser obtained it, he obtained a legal right to recover the par value of the note. The result therefore might be that, although the creditors were entitled to the whole, and the debtor in theory of law is bound to pay the whole, and for aught that appears, is able to pay the whole, and might in fact pay the whole to the purchaser, yet the creditors would lose one-half, and that through the default of the only person placed by law as a trustee to protect their rights.

As a general rule of law, when the same person is bound to pay money in one capacity, and it is his duty to recover it and account for it in another, as he cannot pay himself, the law presumes that he has done what it was his duty and in his power to do, and holds him chargeable, as if actually done. It is upon this principle that an administrator is held bound to account for his own debt to the estate of his intestate as assets; Winship v. Bass, 12 Mass. 203; Ipswich Manufacturing Co. v. Story, 5 Met. 313.

This rule, not founded on any statute or positive rule of law, almost necessarily arises out of the exigencies of the case. The assignee can take no measures to enforce the payment of a debt due by himself, as debtor to himself, as assignee. Knowing that he is a debtor when he assumes the trust and office of assignee, his assent to charge himself with the amount of his debt is tacitly admitted by the acceptance of the office. Whether, if a debtor to the estate of an insolvent should accept the office of assignee, through inadvertence or mistake of the law, or if by losses occurring afterward, should become in part insolvent, he might be allowed to resign, and enable the creditors to choose another assignee, to act as their representative, in collecting such debt of the assignee who has resigned, it is unnecessary to consider, for no such question is presented. Perhaps such a course might, upon a proper case shown, be deemed equitable and reasonable, especially when necessary for the relief of the sureties of the assignee.

It was stated in the facts agreed that at the time of the sale of this note and mortgage, Benchley & Jackson offered to release all their right of redemption of the mortgaged property, to the purchaser. So far as there was value in the mortgaged property over and above prior liens, this might be of use to the purchaser. But it did not diminish or affect the personal liability of the

promisors, including that of the assignee, for the payment of the whole note.

Order of the commissioner requiring the assignee to credit the estate with the whole amount of Benchley & Jackson's note, in his account as assigned, affirmed, and petition dismissed with costs.

Petition dismissed.

Notice of Dissolution—Former Dealers.

AUSTIN v. HOLLAND.

69 N. Y. 571, 25 Am. Dec. 246. 1877.

This action was on a promissory note made in the firm name of Dillon, Beebe & Co., payable to Horace Loveland. Defendant Holland alone appeared and answered. He admitted the making of the note, and that the plaintiff was the holder, but denied that he was a member of the firm. Defendants were copartners under the above firm name prior to the giving of the note. Judgment for the plaintiff on the verdict was affirmed at the General Term of the Supreme Court, and defendant appealed.

ANDREWS, J. The plaintiff was a dealer with the firm of Dillon, Beebe & Co., so as to entitle him to the protection of the rule which makes a retiring partner liable for subsequent engagements made by his former copartner in the firm name with those who had previous dealings with the firm, and who entered into the new transaction without notice of the change in the partnership. * * *

The principal question in this case is whether Loveland had notice of the dissolution of the firm of Dillon, Beebe & Co., which occurred March 29, 1869, prior to August 31, 1869, when the note upon which the action was brought was made. The firm was engaged in the business of the purchase, shipment, and sale of lumber, and its principal office was at Toledo, in the state of Ohio. The plaintiff was employed to purchase lumber in the Western States and in Canada, and resided at Detroit. Notice of dissolution was published in the newspapers at Toledo, and a copy was mailed to the plaintiff, addressed to him at Detroit.

Loveland, on his direct examination, testified positively that

he never received the notice. On his cross-examination he stated that he had no recollection of receiving or seeing the notice, and that, if he had seen it, he thought he should have remembered it. The judge submitted it to the jury to find whether the plaintiff received the notice. The defendants' counsel excepted to the submission of the question to the jury, on the ground that the jury would not be justified in finding from the evidence that the plaintiff did not receive the notice, and upon the further ground that it was immaterial whether he received it or not; that the mailing of the notice was all that the defendant was required to do to protect him from liability for the subsequent services of the plaintiff.

The publication of notice of the dissolution of a partnership in a newspaper at the place where the business was carried on is notice to all persons who have not had prior dealings with the firm; and, if thereafter one of the partners enters into a contract in the firm name with a new customer or dealer, the other partners will not be bound. The rule is different in respect to persons who have dealt with the firm before the dissolution. The rule in such cases in this state requires that, to relieve a retiring partner from subsequent transactions in the partnership name, notice of the dissolution must be brought home to the person giving credit to the partnership. If in any way, by actual notice served, or by seeing the publication of the dissolution, or by information derived from third persons, the party, at the time of the dealing, is made aware of the fact that the partnership has been dissolved, the contract will not bind the firm. It is sufficient to exempt the firm from liability that the person so contracting with a partner in the firm name knew or had reason to believe that the partnership had been dissolved; but this must appear and be found by the jury, or else the contract will be treated as the contract of the partnership. Ketchum v. Clark, 6 Johns. 144, 5 Am. Dec. 197; Graves v. Merry, 6 Cow. 701, 16 Am. Dec. 471; Vernon v. Manhattan Co., 17 Wend. 524; Id., 22 Wend. 183; National Bank v. Norton, 1 Hill, 572; Coddington v. Hunt, 6 Hill, 595; Clapp v. Rogers, 12 N. Y. 287; City Bank v. McChesney, 20 N. Y. 242; Bank of Commonwealth v. Mudgett, 44 N. Y. 514; Van Eps v. Dillaye, 6 Barb. 244; Mechanics' Bank v. Livingston, 33 Barb. 458. In Vernon v. Manhattan Co., the Chancellor says: "But, to exempt the copartners from liability (on a contract with a

previous dealer with the firm), the jury must be satisfied that the person with whom the new debt was contracted either had actual notice that the copartnership was dissolved, or that facts had actually come to his knowledge sufficient to create a belief that such was the fact." The same rule is recognized in the other cases cited, and by elementary writers. 3 Kent's Com. 607; Story on Part. § 161; Coll. on Part. § 533; Lindley on Part. 337. Lindley says: "Those who have dealt with the firm before a change took place are entitled to assume, until they have notice to the contrary, that no change has occurred. * * * If notice in point of fact can be established, it matters not by what means; for it has never been held that any particular formality must be observed." In this case the jury have found that the plaintiff did not receive the notice sent by mail, and had no information of the dissolution of the firm of Dillon, Beebe & Co. prior to the transaction in question. The mailing of notice properly directed to the party to be charged raises a presumption of notice in fact; for it is presumed that letters sent by post to a party at his residence are received by him in due course. Best on Presumptions, § 403. But this is a presumption of fact, and not of law, and may be repelled by proof; and if the receipt of the letter in this case was disproved, then the defendant failed to show the actual notice required in order to exempt him from responsibility, and the question whether the letter was received was, we think, upon the evidence for the jury. The learned counsel for the defendant has not referred us to any case which decides that the mailing of a notice of dissolution is in law equivalent to actual notice and exempts a retiring partner from liability to prior dealers on subsequent engagements in the firm name. Notice by mail of the dishonor of commercial paper is in most cases sufficient by the law merchant to charge an indorser. It is a part of the contract that notice may be given in this way, and it is not material in fixing the liability of the indorser whether he receives it or not.

But we think the rule requiring actual notice of the dissolution of a partnership to prior dealers is a part of the law of this state and should not be departed from. It may subject parties in some cases to inconvenience, but the principle upon which the rule proceeds is that, when one of two parties is to sustain injury from the giving of credit, the one who originally induced it

should bear the loss, rather than the one who, without notice of the change, relied upon the continued existence of the partnership. Story on Part. § 160; Wat. on Part. 384.

The judgment of the General Term should be affirmed.

Judgment affirmed.

CHAPTER V.

POWERS OF PARTNERS.

Test of Authority—Nature of Question.

POOLEY et al. v. WHITMORE.

10 Heisk 629, 633 (Tenn.), 27 Am. Rep. 733. 1873.

BURTON, J. Pooley, Barnum & Co. sued Edwin Whitmore & Co. on two promissory notes, of $185 each, made by W. A. Whitmore, payable at six and nine months, respectively, to the order of "Whitmore Bros.," and indorsed in that name. Whitmore Bros., a firm composed of Edwin Whitmore and the said W. A. Whitmore, were partners in publishing the Public Ledger newspaper in the city of Memphis, and also conducted a general job printing office in that city. The notes in suit, however, were drawn and indorsed by W. A. Whitmore in discharge of a private debt that he owed to one Cannon. Edwin Whitmore is the surviving partner of the firm, and puts in a special plea of non est factum, and insists that the firm is not bound to pay, on the ground that it is not a partnership debt. Defendants in error reply that they are bona fide purchasers for value of the note in due course of trade, and therefore are entitled to recover, notwithstanding the wrong or fraud of W. A. Whitmore in using the partnership name in a personal transaction.

The court below instructed the jury that "as a general rule one partner is not liable for the act of another partner not within the scope of the partnership business; that if one partner sign a promissory note or other negotiable paper in the firm name, without the knowledge or consent of the other partner, and for a matter not within the scope of the partnership business, the other partner will not be liable, unless he ratify the act, or unless the paper get into the hands of some purchaser before maturity who had no knowledge or notice of the consideration between the original parties, and who paid a valuable consideration for the paper; that such a person would be an innocent holder for value and without notice."

The above instructions are not accurate, without important qualifications, and were certainly calculated, as we think, to mislead the jury, in view of the facts of this case.

Every member of an ordinary partnership is its general agent for the transaction of its business in the ordinary way, and the firm is held responsible for whatever is done by any of its partners, when acting for the firm, within the limits of the authority conferred by the nature of the business it carries on. Every person is entitled to assume that each partner is empowered to do for the firm whatever is necessary for the transaction of its business, in the way in which that business is ordinarily carried on by other people. But no person is entitled to assume that any partner has more extensive authority than that above described. It will be observed that what is necessary to carry on the partnership business in the ordinary way is made the test of an authority when no actual authority or ratification can be proved. This is conforming to the most recent and carefully considered decisions; but, by adopting it, the liability of a firm for the acts of its copartners is not so extensive as now lawyers sometimes imagine.

The question whether a given act can or cannot be necessary to the transaction of the business in the way in which it is usually carried on must evidently be determined by the nature of the business and by the practice of persons engaged in it. Evidence on both of these points is necessarily admissible, and, as readily may be conceived, an act which is necessary for the prosecution of one kind of business may be wholly unnecessary for the carrying on of another in the ordinary way. Consequently no answer of any value can be given to the abstract question, can one partner bind his firm by such an act? unless, having regard to what is usual in business, it can be predicated of the act in question either that it is one without which no business can be carried on or that it is one which is not necessary for carrying on any business whatever. There are obviously very few acts of which such an affirmation can be truly made. The great majority of acts which give rise to doubt are those which are necessary in one business and not in another. Take, for example, negotiable instruments. It may be necessary for one member of a firm of bankers to draw, accept, or indorse a bill of exchange on behalf of the firm, and to require that each member should

put his name to it would be ridiculous; but it by no means follows, nor is it in fact true, that there is any necessity for one of several solicitors to possess a similar power, for it is no part of the ordinary business of a solicitor to draw, accept, or indorse bills of exchange. The question, therefore, can one partner bind the firm by accepting bills in its name? admits of no general answer. The nature of the business and the practice of those who carry it on (usage or custom of the trade) must be known before any answer can be given. Lindley on Partnership, 198-200. It is further said by the same author: "It is clearly settled that any member of an ordinary trading partnership can bind the firm by drawing and indorsing promissory notes in its name. But, in respect to partnerships which are not trading partnerships, the question whether one partner has any implied authority to bind his copartners by putting the name of the firm to a negotiable instrument depends upon whether the business of the partnership is such that dealings in negotiable instruments are necessary for its transaction, or are usual in partnerships of the same description. In the absence of evidence showing necessity or usage, the power has been denied to one of several mining adventurers, quarry workers, farmers, and solicitors." Id. 213, 214.

The foregoing principles, as we think, have been fully recognized by this court in Crosthwait v. Ross, 1 Humph. 23, 34 Am. Dec. 613, where the distinction between partners in trade and partners in occupation or employment is taken, and the power of the former class to bind the firm by drawing or indorsing notes and bills is sustained, while it is denied to the latter class. It is there held that one partner in the practice of physic could not bind the firm by drawing a bill or making a note on which to raise money, because it was not within the scope of their partnership, and it was distinctly holden that the power to raise money was not one of the implied powers resulting from such an association. By recurring to the instructions given by the court below in this case, it will be seen that this important distinction between strictly commercial or trading partnerships and partnerships in occupation is entirely ignored, and we think it was the duty of the court to point out the distinction, for prima facie it cannot be said that one partner in a printing office would have the implied power to bind the firm by drawing or indorsing a note.

In this case, to be sure, there was some evidence of the usage of this firm to deal in commercial paper; but there was also evidence tending to the contrary conclusion. The consequence of this distinction between trading and non-trading partnerships is very important in reference to the main defense to be relied upon in this case. If a partner in a banking firm, for instance, should indorse a bill or note for his private debt, and it should get into the hands of a bona fide holder without notice, his firm would be bound by it. The indorsing or making of such paper being the usual mode of conducting that business, the public have a right to suppose that each partner is empowered to accept or indorse for the firm, and are not bound to inquire whether in a given instance the act was done with the assent of his copartners. But not so with a partnership occupation merely, whose business does not ordinarily require dealing in commercial paper. One who becomes a member of such a firm does not confer implied power on his copartners to bind him by dealing in bills or notes. He is not clothed with apparent power so to bind his firm, and no person dealing with the firm has the right to suppose that the powers of one member are more extensive than is implied by the ordinary mode of conducting such business. If two persons are associated in the practice of law, and one of them, without or against the consent of the other, should indorse a note or bill for his private purpose, no one buying such bill could succeed on the plea that he was a bona fide holder without notice, for the reason that by forming such an association the several partners do not hold each other out to the world as empowered to use their names as makers or indorsers of negotiable paper.

The rules in regard to notice to a purchaser are very accurately laid down in our own cases, digested in Heiskell, and contain a much more accurate statement of the law upon the subject than is contained in this charge, and one much more applicable to the facts of the case.

Our conclusion is that the charge of the court in reference to the facts of this case, if it does not amount to a positive misstatement of the law, was calculated to mislead the jury, and that the appellant is entitled to a new trial, although he failed to ask further instructions to the jury.

On hearing this cause at a former term, the court decided to

grant a new trial, and it is now before us on application to reconsider the conclusion at which the court then arrived.

On a reconsideration of the case, we adhere to our former opinion, and reverse the judgment of the municipal court, and remand the cause for a new trial in accordance with the principles herein announced.

Partner's Power to Sell the Firm Property.

LAMBERT'S CASE.

Godb. 244 (Eng.). 1614.

Two men were partners in goods: the one of the partners sold unto J. S., at several times, goods to the value of £100, and for the goods at one time bought he paid the money according to the time; afterwards an action was brought by one of the partners for the rest of the money, and the plaintiff declared upon one contract for the whole goods, whereas in truth they were sold upon several contracts made, and the defendant in that case would have waged his law. But the court advised the plaintiff to be nonsuit, and to bring a new action, because that action was not well brought, for it ought to have been a several action upon the several contract. And in this case it was agreed by the court, that the sale of one partner is the sale of them both; and therefore although that one of them selleth the goods or merchandiseth with them, yet the action must be brought in both their names; and in such case the defendant shall not be received to wage his law, that the other partner did not sell the goods unto him, as is supposed in the declaration.

Partner's Power to Mortgage Firm Property.

TAPLEY v. BUTTERFIELD.

1 Metc. 515 (Mass.), 35 Am. Dec. 374. 1840.

Plaintiff claimed title to the goods under a mortgage. Defendant justified his taking of the goods under a writ of attachment in a suit by firm creditors against the firm of A. & W. A. Blaisdell. The mortgage covered the whole stock of that firm,

and was executed in the names of both partners by A. Blaisdell, with one seal attached. It was given in payment of a firm debt of $650 due to plaintiff. On the trial, W. A. Blaisdell testified that if he had been present he should not have executed the mortgage. Verdict for plaintiff subject to the opinion of the full court.

SHAW, C. J. * * * We are not aware that a mortgage of personal property requires a deed. If an act be done, which one partner may do without deed, it is not the less effectual that it is done by deed. * * * Then treating this as an efficient act of one partner in giving a mortgage upon the partnership property for the security of a partnership debt, is it sufficient to bind the property?

It is within the scope of partnership authority for one partner to sell and dispose of all the partnership goods, in the orderly and regular course of business. It is also within the scope of partnership authority to pay the debts of the firm, and to apply the assets of the firm for that purpose. He, being authorized to sell the goods to raise money to pay their debts, may apply the goods directly to the payment of the debts; and, according to the exigencies of the occasion, he may pledge the partnership goods to raise money to pay the debts of the firm. To this extent we think each partner has a disposing power over the partnership stock, arising necessarily from the nature of that relation. If it were in the form of a consignment to a commission merchant, or an auctioneer, and an advance of money obtained for the use of the firm, we think there could be no question but that it would be within the scope of partnership authority. And now that the law has given encouragement to mortgages of personal property, which is only another mode of pledging goods, and has substituted an instrument in writing capable of being recorded in the town clerk's book, and has given to such record an effect equivalent to the actual delivery of the goods, Bullock v. Williams, 16 Pick. 33, we cannot perceive why it may not be resorted to by partners as well as individual persons. To what extent one partner can bind another in the disposition of the entire property of the concern, is a question of power, arising out of the relation of partnership, and does not, we think, depend upon the form or manner in which it is exercised. Lands held by partners are

considered as lands held by tenants in common; and as one tenant in common cannot pass any estate of his cotenant, and as land cannot pass without deed, it follows that one partner cannot convey away the real estate of the firm without special authority.

But considering that the authority of selling and pledging the personal property is within the scope of partnership power, and may be done by either partner, and considering that it may be done without deed, the court are of the opinion that such a mortgage, made by one partner in the absence of the other, although unnecessarily made by deed, was binding upon the property, and constituted a valid lien upon the property, which the plaintiff may avail himself of. Anderson v. Tompkins, 1 Brock. 456, Fed. Cas. No. 365; Deckard v. Case, 5 Watts (Pa.) 22, 30 Am. Dec. 287.

Judgment on the verdict.

CHAPTER VI.

DUTIES AND LIABILITIES OF PARTNERS AS BETWEEN THEMSELVES.

Duty to Conform to the Partnership Agreement.

MURPHY v. CRAFTS.

13 La. Ann. 519, 71 Am. Dec. 519. 1858.

LAND, J. The plaintiff and defendant were commercial partners, transacting a general commission business under the name and style of Murphy & Crafts in the city of New Orleans. Their contract of partnership was in writing, and the third article thereof was in these words: "We will not indorse any note, draft, or give our signature separately or collectively, except for our legitimate business purposes." Crafts, in violation of this article of the partnership agreement, accepted in the partnership name, for the accommodation of his brother-in-law, John C. Robertson, of the city of Boston, bills of exchange to the amount of $12,500. Robertson failed in business, and the firm of Murphy & Crafts lost, in consequence of these acceptances, the sum of $5,592.90. The principal question in this case is whether Crafts is liable to his partner for the loss. * * *

Judge Story, in his Commentaries on the Law of Partnership, says: "One of the most obvious duties and obligations of all the partners is strictly to conform themselves to all the stipulations contained in the partnership articles, and also to keep within the bounds and limitations of the rights, powers, authorities, and acts belonging and appropriate to the due discharge of the partnership trade, or business. Of course, every known deviation from, and every excess in, the exercise of such rights, powers, authorities, and acts, which produce any loss or injury to the partnership, are to that extent to be borne by the partner who causes or occasions the loss or injury, and he is bound to indemnify the other partners therefor. The same doctrine is recognized by Pothier as existing in the French law; and it

seems, indeed, so clearly the result of natural justice as to require no particular exposition." See Story on Part. § 173.

According to these rules, the defendant is clearly bound to indemnify the plaintiff for the loss resulting from his breach of the third article of their contract of partnership, unless the same was superseded or waived in the course of their business with the assent of the plaintiff. And this is the defense made by the defendant to the action; but we concur with the district judge that the evidence is insufficient to show that the partners came to a new arrangement in the course of their business, and thereby superseded article 3 of their contract, or that the plaintiff ratified the acceptance in favor of Robertson.* * *

Judgment affirmed.

Duty to Observe Good Faith.

MITCHELL v. REED.

61 N. Y. 123, 19 Am. Rep. 252. 1876.

Appeal from judgment of the General Term of the Supreme Court in the First Judicial Department, affirming a judgment in favor of defendant, entered upon decision of the court at Special Term.

This action was brought to have certain leases, obtained by the defendant during the existence of a copartnership between him and plaintiff, for terms to commence at its termination, of premises leased and occupied by the firm, declared to have been taken for the partnership, and to have it adjudged that the defendant held them as trustee for the partnership. * * *

The court found, as conclusions of law, that the defendant, Reed, was the sole owner of the leases executed to him as aforesaid, and that the plaintiff had no right, title, or interest in or to them, or either of them, and that the defendant have judgment accordingly, to which plaintiff duly excepted. Judgment was rendered accordingly. * * *

EARL, C. The relation of partners with each other is one of trust and confidence. Each is the general agent of the firm, and is bound to act in entire good faith to the other. The functions, rights, and duties of partners in a great measure compre-

hend those both of trustees and agents, and the general rules of law applicable to such characters are applicable to them. Neither partner can, in the business and affairs of the firm, clandestinely stipulate for a private advantage to himself. He can neither sell to nor buy from the firm at a concealed profit to himself. Every advantage which he can obtain in the business of the firm must inure to the benefit of the firm. These principles are elementary, and are not contested. Story, §§ 174, 175; Collyer, §§ 181, 182. It has been frequently held that when one partner obtains the renewal of a partnership lease secretly, in his own name, he will be held a trustee for the firm as to the renewed lease. It is conceded that this is the rule where the partnership is for a limited term, and either partner takes a lease commencing within the term; but the contention is that the rule does not apply where the lease thus taken is for a term to commence after the expiration of the partnership by its own limitation, and whether this contention is well founded is one of the grave questions to be determined upon this appeal.

It is not necessary, in maintaining the right of the plaintiff in this case, to hold that in all cases a lease thus taken shall inure to the benefit of the firm, but whether, upon the facts of this case, these leases ought to inure to the benefit of this firm. I will briefly allude to some of the prominent features of this case. These parties had been partners for some years. They were equal in dignity, although their interests differed. The plaintiff was not a mere subordinate in the firm, but, so far as appears, just as important and efficient in its affairs as the defendant. They procured the exclusive control of the leases of the property, to terminate May 1, 1871, and their partnership was to terminate on the same day. They expended many thousand dollars in fitting up the premises, a portion thereof after the new leases were obtained, and they expended a very large sum in furnishing them. By their joint skill and influence they built up a very large and profitable business, which largely enhanced the rental value of the premises. More than two years before the expiration of their leases and of their partnership the defendant secretly procured, at an increased rent, in his own name, the new leases, which are of great value. Although the plaintiff was in daily intercourse with the defendant, he knew nothing of these leases for about a year after they had been obtained. There is no proof

that the lessors would not have leased to the firm as readily as to the defendant alone. The permanent fixtures, by the terms of the leases, at their expiration belonged to the lessors. But the movable fixtures and the furniture were worth vastly more to be kept and used in the hotel than to be removed elsewhere. Upon these facts I can entertain no doubt, both upon principle and authority, that these leases should be held to inure to the benefit of the firm. If the defendant can hold these leases, he could have held them if he had secretly obtained them immediately after the partnership commenced, and had concealed the fact from the plaintiff during the whole term. There would thus have been, during the whole term, in making permanent improvements and in furnishing the hotel, a conflict between his duty to the firm and his self-interest. Large investments and extensive furnishings would add to the value of his lease, and defendant would be under constant temptation to make them. While he might not yield to the temptation, and while proof might show that he had not yielded, the law will not allow a trustee thus situated to be thus tempted, and therefore disables him from making a contract for his own benefit. Terwilliger v. Brown, 44 N. Y. 237, and cases cited. It matters not that the court at Special Term found upon the evidence that the improvements were judicious and prudent for the purposes of the old term. The plaintiff was entitled to the unbiased judgment of the defendant as to such improvements, uninfluenced by his private and separate interest. But, further, the parties owned together a large amount of hotel property in the form of furniture and supplies, considerably exceeding, as I infer, $100,000 in value. Assuming that the partnership was not to be continued after the 1st day of May, 1871, this property was to be sold, or in some way disposed of for the benefit of the firm, and each partner owed a duty to the firm to dispose of it to the best advantage. Neither could, without the violation of his duty to the firm, place the property in such a situation that it would be sacrificed, or that he could purchase it for his separate benefit, at a great profit. Much of this property, such as mirrors, carpets, etc., was fitted for use in this hotel, and it is quite manifest that all of it would sell better with a lease of the hotel than it would to be removed therefrom. It is clear that one or both of these parties could obtain advantageous leases of the hotel for a term of years,

and hence, if the parties had determined to dissolve their partnership, it would have been a measure of ordinary prudence to have obtained the leases and transferred property with the leases as the only mode of realizing its value. This was defeated by the act of the defendant, if he is allowed to hold these leases, and thus place himself in a position where the property must be largely sacrificed or purchased by himself at a great advantage. This the law will not tolerate. The language of Lord Eldon, in Featherstonhaugh v. Fenwick, 17 Ves. 311, a case in many respects resembling this, is quite in point. He says: "If they [the defendants] can hold this lease, and the partnership stock is not brought to sale, they are by no means on equal terms. The stock cannot be of equal value to the plaintiff, who was to carry it away and seek some place in which to put it, as to the defendants, who were to continue it in the place where the trade was already established; and if the stock was sold the same construction would give them an advantage over the bidders. In effect they would have secured the good will of the trade to themselves in exclusion of their partner." For these reasons, independently of the consideration that the leases themselves had a value to which the firm was entitled, upon other grounds and upon authorities, to be hereafter cited, the plaintiff, who commenced his suit about one year before the term of the partnership expired, was, upon undisputed principles and authorities applicable to all trustees and persons holding a fiduciary relation to others, entitled to the relief he prayed for. * * *

I am therefore of opinion that the judgment should be reversed, and new trial granted; costs to abide the event.

Right to Participate in the Management.

KATZ v. BREWINGTON.

71 Md. 79, 20. Atl. 139. 1889.

Charles Brewington filed a bill of complaint against Louis Katz, alleging that in May, 1887, they had entered into a copartnership under the name of L. Katz & Co., and that the business had been carried on under the firm name until the time of the filing of the bill. It was further charged that the

books of the firm were in the possession and control of Louis Katz, who refused to permit complainant to have access to the same, and that Katz had sole control and possession of the goods of the firm, and was disposing of the same in fraud of complainant; that complainant no longer felt safe with the books and assets of said firm in the possession of said Katz, and desired that said copartnership should be wound up under the order and direction of this court; that Katz absolutely excluded complainant from all control of the business, and refused to give him any information in regard to the business of the firm, having carried the books of the firm away from the place of business of said firm, and refused to disclose the place where said books were deposited. * * * The court ordered an injunction, and set down for hearing the application for a receiver, directing that notice should be given to the defendant. The notice was not served in due time, but nevertheless the parties appeared in court, by counsel, on the day appointed for the hearing; and, after the court had heard their statements on the bill and exhibit, it appointed a receiver. After the appointment of a receiver, an answer was filed by defendant, and an appeal was taken.

BRYAN, J. We are, of course, on this appeal, confined to the statements of the bill of complaint. The defendant might have objected to the motion for a receiver on the ground that he had not received the required notice, but he does not appear to have done so. If he had filed his answer before the hearing it would have been considered both in the court below and in this court. The time appointed for the continuance of the partnership had expired before the filing of the bill of complaint, and it was then existing only by the mutual consent of partners. The agreement of partnership required Katz to furnish all the capital, and the profits were to be equally divided after payment of debts and expenses. It was not alleged by complainant that any profits had been made, or that there were any debts due by the partnership. It was, however, alleged that the defendant had excluded him from all control of the business of the firm, and had refused to give him any information respecting it, and had carried away the books from the place of business, and had refused to disclose the place in which they were. Each partner

has an equal right to take part in the management of the business of the firm. Although one of them may have an interest only in the profits, and not in the capital, yet his rights are involved in the proper conduct of the affairs of the firm, so that profits may be made. So each partner has an equal right to information about the partnership affairs, and to free access to its books. The complainant had a right to learn from the books whether there were profits, and whether there were debts. If he were denied this information, as charged in his bill of complaint, a sufficient reason appears for not alleging that profits had been earned, and that debts existed. In Const. v. Harris, 1 Turn. & R. 496, Lord Eldon said: "The most prominent point, in which the court acts, in appointing a receiver of a partnership concern, is the circumstance of one partner having taken upon himself the power to exclude another partner from as full a share in the management of the partnership as he who assumes that power himself enjoys." This principle seems to be universally approved by the authorities. It is decisive of the present question The order must be affirmed.

CHAPTER VII.

REMEDIES OF CREDITORS.

Remedies at Law—Creditors of the Partnership.

MEECH et al. v. ALLEN.

17 N. Y. 300, 72 Am. Dec. 465. 1858.

Appeal from the Supreme Court. The complaint averred these facts: In May, 1847, the plaintiffs recovered a judgment against one Taylor, upon his sole and individual indebtedness, for $8,650.65, which was duly docketed and became a lien upon his real estate. In 1848 Taylor died, seised of real estate in his own individual right, upon which said judgment was a lien. Taylor and one Hiram Pratt, who died in May, 1840, were in their lifetime partners in the business of common carriers upon the Erie Canal and the Great Lakes. A demand arose against them as such partners, which was in litigation when Pratt died, and upon which a judgment was recovered in the Supreme Court, and duly docketed on the 13th of May, 1842, against Taylor, as survivor of himself and Pratt, for $9,990.05, which judgment was assigned to and became the property of the defendant Allen after the death of Taylor and the recovery of the plaintiffs' judgment. In April, 1850, executions were issued upon both of the above-described judgments to the sheriff of Erie, who in virtue thereof, on the 4th of June, 1850, sold certain parcels of the real estate in the city of Buffalo, whereof Taylor died seised in his own right.

The plaintiffs attended at the sale, and gave notice to the defendant of the facts stated, claiming that their judgment was entitled to priority and that the money raised by the sale should be applied first to its satisfaction. The defendant became the purchaser at the sale. There is no other individual property of Taylor out of which the plaintiffs can obtain satisfaction of their judgment except the land thus sold, and there is sufficient

estate of Hiram Pratt, deceased, to satisfy the judgment of the defendant.

The complaint prayed that the land might be resold and the proceeds first applied to the payment of the plaintiffs' judgment, or that the defendant pay to them so much of the proceeds of the sale already had as would extinguish their judgment, with the costs of this action. The defendant demurred, and had judgment in his favor, which was, on appeal, affirmed by the Supreme Court at General Term in the Eighth District whereupon the plaintiffs appeal to this court.

SELDEN, J. It is a settled rule of equity that, as between the joint and separate creditors of partners, the partnership property is to be first applied to the payment of the partnership debts and the separate property of the individual partners to the payment of their separate debts, and that neither class of of creditors can claim anything from the fund which belongs primarily to the opposite class until all the claims of the latter are satisfied. This, however, is a rule which prevails in courts of equity in the distribution of equitable assets only. Those courts have never assumed to exercise the power of setting aside or in any way interfering with an absolute right of priority obtained at law. In regard to all such cases the rule is equitas sequitur legem. 1 Story, Eq. Jur. § 553. * * *

As there is no doubt that at law the judgment for a partnership debt attaches and becomes a lien upon the real estate of each of the partners, with the same effect as if such judgment were for the separate debt of such partner, it is obvious, from the preceding authorities, that the theory upon which the complaint in this case was drawn is erroneous. The principle that the separate property of an individual partner is to be first applied to the payment of his separate debts has, as we have seen, never been held to give priority as to such property to a subsequent judgment for an individual over a prior judgment for a partnership debt. It is true that courts of equity will sometimes give to a mere equitable lien, which is prior in point of time, a preference over a subsequent judgment; but this will be done only where such prior lien is specific in its character, as in the case of White v. Carpenter, 2 Paige, 219. The mere general equity of the separate creditors to have their debts first paid out of the

individual property of the partners does not amount to a lien at all, much less a lien of the kind necessary to give it a preference over a judgment for a partnership debt.

The plaintiffs cannot, under the averments in the complaint, avail themselves of that principle of equity which enables a creditor having a lien upon one fund only to compel a creditor who has a lien, not merely on the same fund, but also upon another, to resort first to the latter, to the end that both may be paid. If the complaint had averred that there was sufficient partnership property, upon which the defendant's judgment was a lien, to satisfy such judgment, it is possible that, under the principle referred to, the plaintiffs might have been entitled to some relief; and in that event it would not have been a valid objection to the complaint that it did not ask for relief appropriate to the case. But the averment in the complaint is simply that there is sufficient estate of the deceased partner, Hiram Pratt, to satisfy the defendant's judgment.

This averment brings the case directly within the doctrine laid down by Lord Eldon in Ex parte Kendall, 17 Ves. 520. He says: "If A. has a right to go upon two funds, and B. upon one, having both the same debtor, A. shall take payment from that fund to which he can resort exclusively, that by those means of distribution both may be paid. That takes place where both are creditors of the same person and have demands against funds the property of the same person. But it was never said that if I have a demand againt A. and B., a creditor of B. shall compel me to go against A., without more, as if B. himself could insist that A. ought to pay in the first instance, as in the ordinary case of drawer and acceptor, or principal and surety, to the intent that all obligations arising out of these complicated relations may be satisfied. But if I have a demand against both, the creditors of B. have no right to compel me to seek payment from A., if not founded in some equity giving B. the right, for his own sake, to compel me to seek payment from A."

The point has also been expressly decided in this state in the case of Dorr v. Shaw, 4 Johns. Ch. 17. The only difference in principle between that case and this is that there it did not appear that the joint debtors were partners. This, however, is a difference which operates against the claim of the plaintiffs here. Where two individuals, not partners, are jointly indebted,

it might seem to be just to presume that each owed one-half, and to that extent, therefore, there might be an equity in favor of the one owing an individual debt to have so much of the joint debt paid by his co-debtor. But in regard to partners it is now well settled, upon an analogous question, that no such presumption can be indulged. Formerly a judgment creditor of one of two partners might levy his execution upon property belonging to the firm, and, upon the presumption that the interests of the partners were equal, might proceed to sell and appropriate one-half the avails to the satisfaction of his debt. This, however, was long since overruled.

In the case of Dutton v. Morrison, Lord Eldon, in discussing this question says: "It may be represented that the world cannot know what is the distinct interest of each (i. e., each partner), and therefore it is better that the apparent interest of each should be considered as his actual interest. But courts of equity have long held otherwise." He then lays down the rule, ever since acted upon, that the creditor in such a case must wait until the partnership accounts are settled before he can claim anything from the partnership property.

The principle here asserted by Lord Elden is directly applicable to the present case. It is that no inference can be safely drawn, from the mere external relations of partners to the world, as to the situation of their affairs inter se, and that, in all judicial proceedings involving the latter, an investigation is first to be made; and such is the variety and frequent complexity of partnership dealings that any other rule would obviously lead to gross injustice. It is impossible, therefore, in this case to assume, without any averments on the subject in the complaint, that the estate of the deceased partner, Pratt, ought, in equity, to pay any portion of the defendant's judgment. Hence, upon the principles laid down by Lord Eldon, and universally acted upon by courts of equity, the complaint is clearly insufficient.

The judgment of the Supreme Court, therefore, should be affirmed, with costs.

Judgment affirmed.

Creditors of the Separate Partners.

JOHNSON v. WINGFIELD et al.

42 S. W. 203. (Tenn.) 1897.

BARTON, J. This cause is before us on bill and demurrer. The demurrer was sustained, and the bill dismissed. Complainant appealed, and assigns errors. The main question presented in the case is whether in this state specific property belonging to the firm is subject to levy for the individual debt of one of the members of the firm. The case made in the bill substantially is as follows: The complainant shows and avers that he had obtained before a justice of the peace in Hamilton county two judgments against the defendant Wingfield, on which executions had been issued and certified, in pursuance of section 3786 of the Code of Tennessee, to Hamblen county, where executions had been issued, which were placed in the hands of a constable, and by him, on the 2d day of January, 1896, levied on the interest of Nisbet Wingfield in a lot of iron pipe and other material, the property of the firm of J. N. Hazelhurst & Co., a firm composed of J. N. Hazelhurst and Nisbet Wingfield, in which firm, it is alleged, Hazelhurst and Wingfield were equal partners. It is further alleged that the interest so levied on in the partnership property was advertised and sold according to law by the constable making the levy at public sale in the city of Morristown, on the 5th of January, 1896. It is further charged that J. N. Hazelhurst and Wingfield continued as partners, under the firm name of Hazelhurst & Co., until January 7, 1896, when the firm dissolved; upon what terms and conditions, complainant does not know, but it is charged that there was no partnership settlement had between the partners, and that the purpose and object of the dissolution of the partnership was to embarrass and defeat the collection of complainant's execution. It is further charged that on January 7, 1896, a new partnership was organized, under the old firm name of J. N. Hazelhurst & Co., composed of J. N. Hazelhurst and D. R. H. Plant, and that this firm was engaged in the completion of the waterworks for the city of Morristown, under the contract made for that purpose by the old company. It is charged that,

after the sale was made, the statement was made by one of the attorneys of Hazelhurst, a member of both firms, who had been present and made a bid at the sale of the property, that Wingfield was no longer a member of the firm, and had no interest in any other property which belonged to the old firm of Hazelhurst & Co. It charged that the new firm, composed of Hazelhurst and Plant, had full knowledge of the complainant's levies; that the property levied on was reasonably worth in the market, at the time of the levy, $3,000; and that Wingfield's interest in the property was at the time of the sale and purchase by the complainant, who was the purchaser at the execution sale, reasonably worth $1,500; that complainant notified Hazelhurst & Co. not to move or interfere with the pipe until his interest was paid for; that Hazelhurst & Co. disregarded the notice and complainant's rights in the property, and converted the same to their use, in the construction of the waterworks, a few days after complainant had purchased Wingfield's interest in the partnership property; that complainant was damaged by the conversion fully $1,500. It is further shown that the new members of the firm of Hazelhurst & Co. were nonresidents; that they had a fund coming to them in the First National Bank of Morristown, against which an attachment was prayed and issued. The prayer of the bill is that a partnership account be had and stated between the defendant J. N. Hazelhurst and Nisbet Wingfield, so as to ascertain what interest Wingfield had in the partnership property described in the levies, and the value of that interest at the time the levies were made, at the time of the sale, and also at the time when the property was converted by J. N. Hazelhurst & Co., and for a decree against J. N. Hazelhurst & Co. and R. H. Plant, or the new firm of Hazelhurst & Co., for the amount so found, and for general relief. It is also shown in the bill that the old firm of Hazelhurst & Co. had other property at the time of the levies besides that levied on, it appearing that certain property was levied on belonging to the firm, and that was released, and levy made on other property. The proceedings before the justice of the peace, the executions, and the return of the officer, are made exhibits to the bill. The officers' return, in substance, is that he levied on all the right, title, and interest which Nisbet Wingfield, as member of the firm of J. N. Hazelhurst & Co., had in the following personal

property, situated and being in Morristown, Tenn., on the Southern Railway's side track, to wit, 25 iron fire plugs, etc., described in the paper. Both executions also show due sale of the property after advertising, the property in each instance being bid in by the complainant, Johnson, for $15. The defendants filed a demurrer and answer, the demurrer being incorporated in the answer; the substance and point of demurrer being that a levy cannot be made on a certain, specific part of partnership property, for the individual debt of one of the members of the firm, as the bill shows was done in this case, and that, to reach a partner's interest in partnership property, the levy must be made upon all the partnership property. The point is made that the partnership owned as an entirety the particular assets of the partnership, and had a right to use the same in the business of the partnership; that the purchaser would be required simply to take the interest of the debtor partner, and would have no right to maintain this bill for trover or conversion of the specific property levied on. The answer filed denies that the interest of Wingfield at the time of the levy amounted to anything, and asserts there was an excess of liabilities at that time over assets. As stated, the demurrer was sustained, and the bill was dismissed. * * *

These extracts will show into what confusion this subject has fallen by reason of the early decisions in all the states, evidently based, as stated by the text-writers from whom we have quoted, on an erroneous conception, or, rather, a failure to recognize the true status of partnership property. It is well settled everywhere that, as to partnership property, partners are trustees of the partnership, as to each other, and the advantages derived from it inure to the benefit of the firm. And it is undoubtedly true that a firm or its members could, by injunction, or other appropriate remedy, prevent a partner from diverting partnership property to his individual use, to the damage of the firm, and could prevent him from exercising rights of possession and control which would be destructive of the purposes, or an injury to the business, of the firm. It is also well settled, as a general rule, that an execution cannot reach any higher interest in property than the debtor himself has; and yet all these decisions which justify an officer in taking exclusive possession of firm property would seem to ignore these just principles,

which are so absolutely necessary to the successful operation of partnership business. It would seem to be a contradiction of terms and principles to hold that the officer only takes and the purchaser only gets the interest which a partner may have in partnership property after a firm has been wound up and liquidated, and the partner's ultimate interest thus ascertained, and that an officer may seize partnership property, and retain exclusive possession of it until the sale, he thus being enabled to do what the individual partner would have no right to do. And it also seems a violation of fundamental rights, and the taking of private property without compensation, to hold, as we understand was held in the case of Haskins v. Everett, supra, that where a partnership has endeavored to assert its rights of possession by a replevin suit as against an officer who had levied on the property for the individual debt of one of its members, it would be liable for damages for the use and detention of its own property. It would seem that many perplexing questions might arise out of this holding. Suppose different executions were levied on different articles or lots of personal property belonging to a partnership for the individual debt of a member of the firm, and on an accounting and liquidation it was ascertained that the interest of the debtor partner was only sufficient to pay one of the claims; what claim would have priority? It seems to be clear that, as long as property has not been converted by a partner, and is being used, or subject to be used, for the legitimate purposes of the partnership, no partner has any certain or exclusive or special interest in any specific partnership property, but it is the property of the entity, the firm. How, then, can a creditor or an officer take any specific interest in any particular piece of property belonging to the firm under such an execution, levy, and sale? Let us suppose that a creditor having a debt amounting in the aggregate to about $500, as in this case, levies on partnership property worth $3,000, and another creditor, having a debt of $1,500, levies at a subsequent time on another article of partnership property worth $1,500. On an accounting it is ascertained that the debtor partner's interest in the firm at the time of the levies amounted to $1,500. The property worth $3,000 was sold, and bid in by the execution creditor, at $500, in satisfaction of the first debt mentioned. What will be the result? At the time of the first

levy, if the debtor partner is to be charged with one-half the property levied on, as taken out in his interest, it would absorb all his interest in the firm. In other words, does the levy on specific property appropriate any specific property, or only the debtor's interest in the firm? It would seem that by far the more sensible and enlightened method of reaching a partner's interest in the firm would be by garnishment, as provided by statute in Georgia; and, as said in Freem. Ex'ns, it would seem to be a subject deserving of legislative attention. The hardship that might result from carrying out the rule laid down in this state in the cases in 4 Sneed, 531, and 12 Heisk. 317, could be well illustrated by this case, where the firm had a contract to build an extension system of waterworks. A part of the material necessary to the completion of the contract was levied on and sold by an officer for the individual debt of one of the members, and it is stated in the bill that the purchaser, the complainant in this case, notified the other partner that he must not move or do anything with this property until his interest was paid for. It seems that this partner paid no attention to this direction; and it would clearly appear that, if the complainant had had it in his power to enforce the directions given by him, it would not only have resulted in great damage and ruin to the firm's business, but also to the other partner, who was in no way to blame for Wingfield's indebtedness. But, whatever trouble may arise from these holdings we do not feel at liberty, in this court, to depart from what we understand to be well-settled principles in this state. Nor do we wish to be understood as criticising the holdings of our Supreme Court upon this subject, further than to call attention to the seeming inconsistencies that arise therefrom, and which are common to all the earlier cases in almost every state in the Union, as well as in England. But, for the purposes of this case, we may state that we understand the decisions in this state from which we have above quoted to settle the following points: (1) That partnership property may be levied on by the creditor for the individual debt of a member of the firm. (2) That specific property may be levied on, and it is not necessary that the execution be levied upon all the property of the firm. (3) That the officer may, and that in fact it is his duty to, take actual possession of the property levied on, and to retain it until the sale is made. (4) That the

purchaser only takes the interest of such judgment debtor after the settlement and adjustment of the partnership accounts, as is the language used in the case of Haskins v. Everett, supra, or a mere right to an accounting, as stated in another case. (5) That, as stated by Judge Freeman in Lincoln Sav. Bank v. Gray, 12 Lea, 459, a levy is necessary in order to fix a lien so as to authorize the filing of a bill.

These points being settled, it results, in our opinion, that the chancellor was in error in dismissing the complainant's bill. While we think that Hazelhurst had the right to use, and properly, whether by himself, or by the new firm of Hazelhurst & Co., used, the iron which had been levied on, in carrying out the contract and business of the old firm, still it is the logical effect of the decisions which we have quoted that the creditor, Johnson, having the right to have the property levied on, by the sale and purchase took whatever interest Wingfield had in his property at that time, which could only be ascertained by an accounting, and that this he has a right to do. If it should turn out on an accounting that at the time of the levy the liabilities of the firm as claimed in the answer filed with the demurrer, exceeded the assets, and that the firm was insolvent, then Johnson will, of course, take nothing by his purchase; and it is also clear that Johnson's interest could not exceed the value of Wingfield's share in all the partnership assets after all partnership debts were paid, and all charges against him in favor of Hazelhurst were settled. The logical result of our cases on this subject seems to be that the taking by the officer has practically the same effect as the withdrawal and conversion of that amount of property by the debtor member of the firm, subject to being compelled to return such an amount of the property after the exhaustion of other partnership property as might be necessary to pay all partnership debts, and to secure to the other partner his just share and division of the partnership assets. For these reasons the decree of the chancellor will be reversed, and the cause remanded to be further proceeded with, with directions to refer the cause to the master to take an account, and to ascertain and report the condition of the old firm of Hazelhurst & Co. at the time of the levies made, as shown in the bill; and the complainant will be entitled to a decree for the value of Wingfield's interest in the property levied on, if any, on the lines

indicated in this opinion. The decree of the chancellor is reversed, the demurrer overruled, and the cause remanded, as stated, and the defendants will pay the costs of the appeal.

Remedies in Equity—Insolvency or Bankruptcy of Firm.

RODGERS v. MERANDA et al.

7 Ohio St. 179. 1857.

The original proceeding was a petition for an order of distribution of the separate or individual assets of an insolvent debtor, as between separate and partnership creditors.

It appears from the record that about the 13th of June, 1854, Peter Murray, an insolvent debtor, made an assignment of all his estate, real and personal, to the plaintiff, in trust for the payment of his individual creditors in proportion to the amount of their respective demands. Though possessed of a large and valuable estate, it had been found insufficient to pay his separate debts and liabilities in full. At the date of his failure and assignment he was a partner with John W. Dever in a mercantile firm under the name and style of Dever & Murray; which firm had also become insolvent, and likewise Dever; and the firm had made an assignment of the partnership property and assets about the same time to John Meranda, one of the defendants, in trust for the payment of the joint debts or liabilities of the firm.

In this condition of affairs the partnership creditors, although they have filed their claims with the assignee of the firm for their distributive shares out of the partnership property, claim the right to be admitted to a participation in the dividends of the separate estate of Murray, pari passu with his individual creditors; while the latter deny the right, and insist that his separate estate shall be applied to the satisfaction of his individual debts in preference to his partnership debts.

It appears, further, that Murray, besides advancing his part of the capital of the firm, also loaned money to the firm to a large amount, for which he held the obligations of the firm, which obligations, by the assignment of Murray, came into the hands of the plaintiff, who has presented the same to the assignee of the firm, and claims to have the same paid out of the assets

of the firm, pari passu with the other partnership debts. The other creditors resist this, and plaintiff asks an order of distribution to that effect out of partnership assets.

Defendants demurred to the petition. The court below sustained the demurrer, and gave judgment in favor of the defendants; and this petition in error is filed to review and reverse that judgment.

BARTLEY, C. J. Two questions are presented for determination in this case. The first is whether, in the distribution of the assets of insolvent partners, where there are both individual and partnership assets, the individual creditors of a partner are entitled to be first paid out of the individual effects of their debtor, before the partnership creditors are entitled to any distribution therefrom. It is well settled that, in the distribution of the assets of insolvent partners, the partnership creditors are entitled to a priority in the partnership effects, so that the partnership debts must be settled before any division of the partnership funds can be made among the individual creditors of the several partners. This is incident to the nature of partnership property. It is the right of a partner to have the partnership property applied to the purposes of the firm, and the separate interest of each partner in the partnership property is his share of the surplus after the payment of the partnership debts. And this rule, which gives the partnership creditors a preference in the partnership effects, would seem to produce, in equity, a corresponding and a correlative rule, giving a preference to the individual creditors of a partner in his separate property; so that partnership creditors can, in equity, only look to the surplus of the separate property of a partner, after the payment of his individual debts, and, on the other hand, the individual creditors of a partner can in like manner only claim distribution from the debtor's interest in the surplus of the joint fund after the satisfaction of the partnership creditors. The correctness of this rule, however, has been much controverted; and there has not been always a perfect concurrence in the reasons assigned for it by those courts which have adhered to it. * * *

The remaining matter for determination in this case involves the inquiry whether, in case of an indebtedness for money, lent

to the partnership by a partner who afterward becomes insolvent, the separate creditors of the latter shall be entitled therefor to a pro rata distribution with the partnership creditors out of the joint fund. It is claimed that the liability of the firm to a partner for money loaned is a partnership debt, and that the individual creditors of that partner are, in equity, entitled to an equal distribution therefor out of the partnership property. On the other hand, it is claimed that as each partner is individually liable for the debts of the firm, and as no partner can be allowed to participate with his own creditors in the distribution of a fund, the separate creditors of a partner, as they can only claim through the rights of their debtor, cannot be allowed such participation with the joint creditors. * * *

The separate creditors of Murray, therefore, are not, on account of this claim for money lent by Murray to the firm, entitled to participate with the partnership creditors in the distribution of the joint effects.

Judgment of the common pleas reversed, and ordered that the separate effects of Peter Murray be distributed pro rata, first among his individual creditors, before any application thereof be made to the payment of the partnership debts of Dever & Murray, and that the partnership effects be applied first to the payment of the partnership debts, irrespective of the claim of the partner, Peter Murray, of money loaned by him to the firm.

CHAPTER VIII.

ACTIONS BETWEEN PARTNERS.

Equitable Actions in General—Jurisdiction.

BRACKEN v. KENNEDY et al.

4 Ill. 558. 1842.

CATON, J. This was a bill in chancery, filed in the La Salle circuit court by the complainant against the defendants, for an account among partners. The bill states that in July, 1837, the complainant and defendants entered into partnership as canal contractors, and as such partners contracted with a canal company in Virginia for the construction of section 120 of their canal, and that they completed said section 120 in August, 1838; that during the progress of the work the complainant and Brady had the principal management of its construction, while most of the time Kennedy was absent; that at the same time Kennedy had an individual contract for the construction of sections 118 and 119 of the same canal, and Kennedy employed the complainant to superintend the completion of these sections; that this individual contract of Kennedy was unprofitable, and in the course of its progress he became indebted to the copartnership section 120, to about $8,000 for work and labor expended on sections 118 and 119; that the whole estimate for the company section, 120, was $32,320.90, including the work done on Kennedy's individual sections, and that the costs of the same were $23,738.82, leaving a balance of profits to be divided among the partners of $8,437.08; that the complainant has accounted with and paid over to Brady his third of the said profits; and that there is now due from Kennedy to the complainant the sum of $3,959.03, arising from said partnership transactions; that Kennedy has drawn estimates on the works, and has drawn his last on his individual contracts; that no account has been taken or rendered between the said partners; and that Kennedy

refuses to account. The bill prays that an account may be taken, etc.

To this bill a demurrer was filed, which was sustained, and the bill dismissed.

The first assignment of error is upon the decision of the court in sustaining the demurrer, and this is the principal question in the case.

In matters of controversy or difficulty between partners, it is now most usual, and by far the most convenient, to resort to a court of equity for their final adjudication and settlement. The practice of this court is much better adapted to unravel and definitely settle such complicated questions as frequently arise among partners than a court of law; and it is now one of the most usual proceedings to be met with in courts of equity. It is not unusual that almost the entire proof of the merits of a case between partners is locked up in the bosoms of the parties themselves, or is contained in books and papers in the possession of one or the other party, and this court can afford the only key to the disclosure of the one or the production of the other. Here either party may compel the other to purge his conscience on oath and declare the truth; and the court will compel the production of all such papers and books as may be necessary to elucidate the rights and liabilities of the parties. It is for this reason that courts of equity have frequently exercised a concurrent jurisdiction with courts of law in long and intricate accounts, running on both sides, between parties who are not partners and have no interests in common.

It is true that courts of law still pretend to afford a remedy, in case of difficulty between partners, by the action of account; but it is so incomplete and unsatisfactory that it is now nearly obsolete, and the complaining partner almost universally lays his complaint before a court of chancery, where he finds a prompt and efficient remedy, from the superior facilities which it possesses of doing complete justice between the parties.

In a bill of this character the existence of the partnership, the transaction of business by the firm, and no account among its members, are prominent features, and where they all appear I am not prepared to say that the bill ought not in all cases to be retained. In this case the bill shows that there was a special and limited partnership, the particular object of which

is stated in it, as well as the nature and amount of the business transacted by the firm, and that no account has been had between the complainant and the defendant Kennedy, who refuses to account. Here, then, is such a case as requires the interposition of a court of chancery to settle and adjust the rights and claims of the several partners. It is true that the bill states that the complainant and Brady have settled as between themselves, and that the complainant has succeeded to all of the rights and interests of Brady in the partnership business; but this does not make it the less necessary that an account should be had between the complainant and Kennedy, to settle their respective rights; and to accomplish this it was necessary to make Brady a party to the bill. The bill also states that the partnership advanced to Kennedy, one of its members, in work and labor, etc., to the amount of some $8,000, which is nearly the extent of the partnership profits, thus showing substantially that Kennedy had received nearly all of the profits of the work on section 120. In what way could this be recovered back by the other members of the firm, or in what way could he be compelled to account for these advances, unless by the mode here adopted? One member of a partnership cannot sue the firm at law for advances made by him to the joint concern; nor can the firm sue an individual partner for anything that he may have drawn out of the joint stock or proceeds, no matter how much more than his share it might have been; and the reason is that one man cannot occupy the double position of plaintiff and defendant at the same time. 1 Story Eq. 616. The aid of this court is just as necessary to settle the account of these advances as it is to settle the accounts arising out of the immediate transactions of the special business of the partnership.

The bill, then, being sufficient in substance, although not so particular as might be desirable, the demurrer should have been overruled. * * * The decision of the court below is reversed, and the cause remanded, with directions that the complainant be permitted to amend his bill, if he thinks proper, and with leave for the defendant to answer.

Decree reversed.

CHAPTER X.

TERMINATION OF A PARTNERSHIP.

By the Act of a Single Partner.

SOLOMON v. KIRKWOOD et al.

55 Mich. 256, 21 N. W. 1884.

COOLEY, C. J. The plaintiffs, who are in the city of Chicago dealers of jewelry, seek to charge the defendants as partners upon a promissory note for $791.92, bearing the date of November 9, 1882, and signed "Hollander & Kirkwood." The note was given by the defendant Hollander, but Kirkwood denies that any partnership existed between the defendants at the date of the note.

The evidence given on the trial tends to show that on July 6, 1882, Hollander & Kirkwood entered into a written agreement for a partnership for one year from the 1st day of the next ensuing month in the business of buying and selling jewelry, clocks, watches, etc., and in repairing clocks, watches, and jewelry, at Ishpeming, Mich. Business was begun under this agreement, and continued until the latter part of October, 1882, when Kirkwood, becoming dissatisfied, locked up the goods and excluded Hollander altogether from the business. He also caused notice to be given to all persons with whom the firm had had dealings that the partnership was dissolved, and had the following inserted in the local column of the paper published at Ishpeming: "The copartnership heretofore existing between Mr. C. H. Kirkwood and one Hollander, as jewelers, has ceased to exist; Mr. Kirkwood having purchased the interest of the latter." This was not signed by any one.

A few days later Hollander went to Chicago, and there, on November 9, 1882, he bought, in the name of Hollander & Kirkwood, of the plaintiffs goods in their line amounting to $791.92, and gave to the plaintiffs therefor the promissory note now in the suit. The note was made payable December 15, 1882, at a bank in Ishpeming. When the purchase was completed, Hol-

lander took away the goods in his satchel. The plaintiffs had before had no dealings with Hollander & Kirkwood, but they had heard there was such a firm, and were not aware of its dissolution. They claim to have made the sale in good faith and in the belief that the firm was still in existence. On the other hand, Kirkwood claimed that Hollander and the plaintiffs had conspired together to defraud him by a pretended sale to the firm of goods which the plaintiffs knew Hollander intended to appropriate exclusively to himself; and he was allowed to prove declarations to Hollander which, if admissible, would tend strongly to prove such a conspiracy.

The questions principally contested on the trial were, first, whether the acts of Kirkwood amounted to a dissolution of the partnership; second, whether sufficient notice of dissolution was given; and, third, whether there was any evidence to go to the jury of an understanding between Hollander and the plaintiffs to defraud Kirkwood. The trial judge, in submitting the case to the jury, instructed them: That Kirkwood, notwithstanding the written agreement, had a right to withdraw from the partnership at any time, leaving matters between him and Hollander to be adjusted between them amicably or in the courts; and for the purposes of this case it made no difference whether Kirkwood was right or wrong in bringing the partnership to an end. If wrong, he might be liable to Hollander in damages for the breach of his contract. Also, that when partners are dissatisfied, or they cannot get along together, and one partner withdraws, the partnership is then at an end as to the public and parties with whom the partnership deals, and neither partner can make contracts in the future to bind the partnership, provided the retiring partner gives the proper notice. Also, that if they should find from the evidence that there was trouble between Hollander and Kirkwood prior to the sale of the goods and the giving of the note, that Kirkwood informed Hollander in substance that he would have no more dealings with him as partner, that he took possession of all the goods and locked them up, and from that time they ceased to do business, then the partnership was dissolved. Further, that whether sufficient notice had been given of the dissolution was a question for the jury. Kirkwood was not bound to publish notice in any of the Chicago papers. He was only bound to give actual notice to such parties

there as had dealt with the partnership. But Kirkwood was bound to use all fair means to publish as widely as possible the fact of a dissolution. Publication in a newspaper is one of the proper means of giving notice, but it is not absolutely essential; and on this branch of the case the question for the jury was whether Kirkwood gave such notice of the dissolution as under the circumstances was fair and reasonable. If he did, then he is not liable on the note; if he did not, he would still continue liable.

The judge also submitted to the jury the question of fraud in the sale of the goods. The jury returned a verdict for the defendants.

We think the judge committed no error in his instructions respecting the dissolution of the partnership. The rule on this subject is thus stated in an early New York case: The right of a partner to dissolve, it is said, "is a right inseparably incident to every partnership. There can be no such thing as an indissoluble partnership. Every partner has an indefeasible right to dissolve the partnership as to all future contracts by publishing his own volition to that effect; and after such publication the other members of the firm have no capacity to bind him by any contract. Even where partners covenant with each other that the partnership shall continue seven years, either partner may dissolve it the next day, proclaiming his determination for that purpose; the only consequence being that he thereby subjects himself to a claim for damages for a breach of his covenant. The power given by one partner to another to make joint contracts for them both is not only a revocable power, but a man can do no act to divest himself of the capacity to revoke it." Skinner v. Dayton, 19 Johns. (N. Y.) 513, 538, 10 Am. Dec. 286. To the same effect are Mason v. Connell, 1 Whart. 381 (Pa.), and Slemmer's Appeal, 58 Pa. 155, 98 Am. Dec. 248. There may be cases in which equity would enjoin a dissolution for a time, when the circumstances were such as to make it especially injurious; but no question of equitable restraint arises here. When one partner becomes dissatisfied, there is commonly no legal policy to be subserved by compelling a continuance of the relation, and the fact that a contract will be broken by the dissolution is no argument against the right to dissolve. Most contracts may be broken at pleasure, subject, however, to re-

sponsibility in damages; and that responsibility would exist in breaking a contract of partnership as in other cases.

The instruction respecting notice was also correct. No court can determine for all cases what shall be sufficient notice and what shall not be. The question must necessarily be one of fact.

But we think the judge erred in receiving evidence of Hollander's admissions or declarations tending to show fraudulent collusion between him and the plaintiffs. * * *

For this error there must be a new trial.

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